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Supreme Court of the United States

October Term, 1973.

No. 73-99

IN RE
KAUFFMAN MUTUAL FUND ACTIONS.

JOSEPH B. KAUFFMAN,
Petitioner.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

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JOSEPH B. KAUFFMAN,

Petitioner.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

Joseph B. Kauffman hereby petitions that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the First Circuit entered on May 14, 1973 and the memorandum and order on petition for rehearing of the United States Court of Appeals for the First Circuit entered on June 4, 1973.

OPINIONS BELOW.

The opinion of the United States District Court for the District of Massachusetts is not yet officially reported and is printed in the Appendix at pp. A1-A19. The majority and concurring opinions of the United States Court of Appeals for the First Circuit and its memorandum and order on petition for rehearing are not yet officially reported and are printed in the Appendix at pp. A23-A39 and pp. A42-A44, respectively.

JURISDICTION.

The First Circuit's judgment was entered on May 14, 1973 (App., p. A40). Petitioner's timely petition for rehearing was denied on June 4, 1973 (App., pp. A42-A44). The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

QUESTIONS PRESENTED.

Petitioner commenced this action in federal district court under Sections 4 and 16 of the Clayton Act alleging, *inter alia*, industry-wide violations of the federal antitrust laws by the defendant mutual funds, their investment advisers, their affiliated directors and their trade association representative. Petitioner's complaint alleged the futility of making a demand upon directors (App., p. B3) and the reasons for such futility (App., pp. B7-B9).

Nevertheless, petitioner's derivative suit, on behalf of the four mutual funds in which he was a stockholder, was dismissed by the district court on the procedural grounds that: (a) he had not "shown adequate reason to excuse himself from making a demand on the board of directors" because of a rebuttable statutory presumption contained in the Investment Company Act of 1940 providing that unaffiliated directors are not controlled; and (b) that he had failed to comply with a strict Massachusetts precondition to derivative suits requiring a demand upon and approval by stockholders (App., pp. A9-A19).

On appeal, the United States Court of Appeals for the First Circuit rejected the reasoning of, but reached the same result as, the district court on the director demand issue and failed to reach the district court's disposition of the stockholder demand issue (App., pp. A23-A28). As a result, petitioner's derivative suit was dismissed *without*

opportunity to amend: (a) because he had not made a demand upon the *unaffiliated directors* of the four mutual funds even though he had alleged that such demand would be futile because their boards of directors, including their unaffiliated directors, had participated in, approved of and acquiesced in the alleged continuing antitrust violations and that their boards of directors, including their unaffiliated directors, were dominated and controlled by their *affiliated* directors and investment advisers; (b) even though petitioner could have alleged even more explicitly, if he had been afforded the opportunity, that the *unaffiliated* directors who would have voted on his demand, had he made one, were essentially the same ones that composed the boards of directors when the antitrust violations were approved, renewed and permitted to continue; and (c) because he had not made a demand upon the stockholders of the two Massachusetts mutual funds in which he owned stock, as required by a strict Massachusetts rule, even though the imposition of such a strict state requirement would effectively nullify a federal antitrust action over which the federal district courts have exclusive jurisdiction. The lower courts, moreover, disregarded the additional proof of hostility and futility vividly demonstrated by the fact that the boards of directors had vigorously resisted this action for three years.

Therefore, the questions presented are:

1. May a derivative suit commenced under Rule 23.1 of the Federal Rules of Civil Procedure be dismissed, without opportunity to amend, because demand has not been made upon the *unaffiliated directors* sitting on the boards of directors of four mutual funds even though:

(a) It was alleged in the complaint that the *entire* boards of directors, including the unaffiliated directors, had participated in, approved of and acquiesced in the

alleged antitrust violations and that the *entire* boards of directors, including the unaffiliated directors, were dominated and controlled by their *affiliated* directors and investment advisers;

(b) Petitioner could have alleged even *more explicitly*, if he had been afforded the opportunity, that the *unaffiliated* directors who would have voted on petitioner's demand, had he made one, were essentially the same ones that composed the boards when the allegedly illegal contracts in question were approved and the allegedly illegal noncompetition was permitted to continue; and

(c) The boards of directors, including the unaffiliated directors, have been vigorously defending this action for more than three years?

2. May a derivative suit commenced in a *federal* court under Rule 23.1 of the *Federal* Rules of Civil Procedure, alleging a cause of action based on *federal* antitrust statutes over which the *federal* courts have *exclusive* jurisdiction be dismissed for failure to comply with a *state* judicially imposed *state* requirement of prior demand upon *and* approval by tens of thousands of stockholders, the effect of which would be the nullification of private enforcement of the *federal* antitrust statutes by derivative suits?

PROCEDURAL RULE INVOLVED.

The procedural rule involved herein, namely Rule 23.1 of the Federal Rules of Civil Procedure, provides, in pertinent part, that:

"DERIVATIVE ACTIONS BY SHAREHOLDERS

"In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. *The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. . . .*" (Emphasis supplied.)

STATEMENT OF THE CASE.

A. The History of Proceedings Herein.

The ten consolidated Kauffman Mutual Fund actions ("KMF actions") were originally part of one complaint,[1] which had been instituted by petitioner under Sections 4 and 16 of the Clayton Act (15 U. S. C. § 15 and § 26) for treble damages and equitable relief. The gravamen of petitioner's KMF actions was that, since at least 1965 and continuing at least to the filing of the complaint, defendants have engaged in a combination and conspiracy with horizontal and vertical agreements, to fix management fees and to refrain from competition for the business of advising mutual funds and the business of obtaining investment advice in violation of Sections 1 and 2 of the Sherman Act (15 U. S. C. §§ 1 and 2).

Although petitioner's complaint was filed on December 18, 1968, *more than four and one half years ago,* petitioner has *never* been permitted to commence any discovery. The reason for this anomalous situation is that, at the threshold of this action, the district court adopted, at defendants' request and over petitioner's vigorous objection, a procedure permitting defendants to file and argue their preliminary motions to dismiss *seriatim.* Pursuant to this procedure, defendants have been able to forestall all discovery while petitioner was responding to defendants' various motions to dismiss in three separate stages.

Petitioner's standing to sue has been limited to a derivative suit on behalf of the four mutual funds in which

1. Petitioner's initial complaint consisted of three counts. However, as the result of a prior interlocutory appeal to the Third Circuit, *Kauffman v. Dreyfus Fund, Inc.,* 434 F. 2d 727 (3d Cir. 1970) *cert. denied* 401 U. S. 974 (1971), petitioner's complaint was virtually reduced to one count, *i.e.* petitioner's antitrust action contained in his first count (App., pp. B1-B10).

he owned stock. *Kauffman v. Dreyfus Fund, Inc.*, 434 F. 2d 727 (3d Cir. 1970) *reversing* 51 F. R. D. 18 (D. N. J. 1969). Although the Third Circuit also vacated the stay of all proceedings which had prevented petitioner from commencing any discovery, the district court on remand continued to permit defendants to raise and argue their preliminary motions to dismiss *seriatim* and continued the stay on petitioner's discovery.

Thereafter, nearly all of the defendants brought on for disposition their *second group* of motions attacking jurisdiction over the person, venue and service of process. In order to avoid further delay, petitioner agreed that, as to each moving defendant, the action could be transferred pursuant to 28 U. S. C. § 1406(a) to a district court designated by each of them.

In an effort to reduce court congestion, conserve judicial energies, avoid conflicting discovery demands and rulings and foster uniform results on the merits, petitioner then moved before the Judicial Panel on Multidistrict Litigation ("JPML") for pretrial consolidation under 28 U. S. C. § 1407. On January 21, 1972, the JPML ordered the transfer of the KMF actions to the United States District Court for the District of Massachusetts for consolidated pretrial proceedings. *In re Kauffman Mutual Fund Actions*, 337 F. Supp. 1337 (J. P. M. L. 1972).

B. The Decision of the District Court.

It was not until more than three years after the commencement of this action that defendants filed and brought on for hearing in the district court the *third group* of their preliminary motions to dismiss.[2] The district court

2. Petitioner's discovery was again stayed while the district court considered defendants' third group of motions.

held that: (1) with regard to all four Kauffman funds,[3] petitioner had failed to comply with Rule 23.1 since he had not demonstrated adequate reason to excuse making a demand upon their directors (App., pp. A16-A19); and (2) with regard to the two Kauffman funds incorporated in Massachusetts, petitioner had failed to comply with the strict Massachusetts requirement compelling demand upon *and* affirmative approval by their tens of thousands of stockholders (App., pp. A9-A16).

The basis for the district court's decision on the director demand issue was defendants' affidavits, which neither denied domination nor asserted independence, but merely alleged that, at the time of the commencement of this action, the majority of the directors of each of the four Kauffman funds were unaffiliated, *i.e.* not associated in any capacity with its investment adviser. The district court then erroneously concluded that a *rebuttable* statutory presumption contained in § 2(a)(9) of the Investment Company Act of 1940 (15 U. S. C. § 80a-2(a)(9)) *established,* even at the pleading stage notwithstanding allegations to the contrary, that such unaffiliated directors were irrefutably independent and not controlled and that, because of the rebuttable statutory presumption, petitioner had not "shown adequate reason to excuse himself from making a demand on the boards of directors." (App., pp. A16-A19). The astonishing result of the district court's decision on this issue was that a rebuttable statutory presumption, which was intended *solely* to shift the burden of proof at trial,[4] was used at the pleading stage to refute peti-

3. Hereinafter, the four mutual funds in which petitioner owns stock, namely The Dreyfus Fund, Inc., The Putnam Growth Fund, Fidelity Trend Fund, Inc. and Manhattan Fund, Inc., will be referred to as the "four Kauffman funds."

4. See n. 5 at p. 9, *infra,* and *Phillips v. Securities and Exchange Commission,* 388 F. 2d 964 (2d Cir. 1968).

tioner's contrary allegations even though petitioner's repeated requests for discovery had been denied.

In reaching its decision on the stockholder demand *and* approval issue with respect to the two Massachusetts mutual funds, the district court was apparently persuaded by petitioner's arguments (App., pp. A14-A15). However, instead of following the reasoning of the First Circuit's opinion in *Levitt v. Johnson*, 334 F. 2d 815 (1st Cir. 1964) *cert. denied* 379 U. S. 961 (1965), the district court expressly relied upon a footnote in the same opinion (App., pp. A15-A16). The incongruous consequence of the district court's decision on this issue was that a complaint commenced under the *federal* antitrust laws on behalf of four mutual funds was dismissed as to the two Kauffman funds incorporated in Massachusetts, but not as to the two Kauffman funds incorporated in New York, *solely* because of a failure to comply with a restrictive, non-uniform *state* policy which admittedly would nullify the *federal* cause of action.

C. The Decision of the Court of Appeals.

The Court of Appeals, with Chief Judge Coffin writing a concurring opinion, affirmed the holding of the district court on the director demand issue, albeit on completely different grounds, and declined to adjudicate the shareholder demand issue. In affirming, the majority rejected the use of the rebuttable statutory presumption to refute petitioner's complaint,[5] but found that petitioner's allegations were insufficiently particularized to excuse a demand

5. As the panel majority stated (App., p. A28):

"Although certain facts were presented by affidavit, n. 3, ante, basically the motion to dismiss tested the sufficiency, *vel non*, of the complaint. The presumption supplied by 15 U. S. C. § 80a-2(a)(9) that '[a] natural person shall be presumed not to be a controlled person,' whatever may be its effect at a trial, could not be used to contradict the complaint, if plaintiff is correct that the court so employed it."

upon a board of directors composed of an unaffiliated director majority because:

> (1) Although the unaffiliated directors had vigorously resisted petitioner's suit for more than three years, they had not done so on "substantive" grounds (App., pp. A29-A30);
>
> (2) Petitioner's complaint failed to allege with sufficient particularity that "the unaffiliated directors who would have voted on [petitioner's] demand in 1968, had he made one, were the same ones (and hence, assertedly, impervious to a demand) that composed the boards when the contracts in question were approved" (App., pp. A30-A31); and
>
> (3) Unaffiliated director approval of mutual fund transactions, which violated the federal antitrust laws, was immaterial when the court can *prima facie* conclude that such mutual fund transactions, even though illegal, were serving the interests of the corporation rather than the personal or financial interests of their affiliated directors (App., pp. A31-A36).

In his concurrence, Chief Judge Coffin rejected reasons one and three, but agreed that "the absence of an allegation or indication in the affidavits . . . 'that the unaffiliated directors who would have voted on [petitioner's] demand in 1968, had he made one, were the same ones . . . that composed the boards when the contracts in questions were approved'" was "fatal." (App., pp. A36-A39).

In addition to filing a petition for rehearing, petitioner filed an affidavit[6] demonstrating that, based on sworn statements filed by the four Kauffman funds with the

6. Petitioner's affidavit is reprinted in the Appendix at pp. C1-C7.

Securities and Exchange Commission ("SEC"), the unaffiliated directors who would have voted on [petitioner's] demand in December 1968, had he made one, were essentially the same ones that composed the boards when the contracts in question were approved.

The Court of Appeals accepted petitioner's affidavit only for identification purposes (App., p. A41) and denied the petition for rehearing (App., pp. A42-A44). It also rejected petitioner's request that the action be remanded to permit him to amend his complaint so that he could even *more explicitly* allege that the unaffiliated directors who would have voted on his demand, had he made one, were essentially the same ones that composed the boards when the contracts were approved (App., p. A43). The Court of Appeals' refusal to permit petitioner's amendment was particularly unfair, since petitioner had been contesting defendants' other motions to dismiss for the previous three years, since the Court of Appeals' decision was the first one that found petitioner's pleading deficient in and of itself and since the Court of Appeals knew that petitioner could have alleged facts to overcome its objection.

Upon motion, the Court of Appeals stayed the issuance of its mandate until July 11, 1973 (App., p. A45).

Thus, the basic issue here is whether an unjustifiably narrow reading of the complaint and an erroneous application of Rule 23.1 will be permitted to bar absolutely a shareholder's derivative suit attacking the illegal and harmful practice whereby mutual fund investment advisers fix excessively high management fees and agree not to compete for the investment adviser contracts of each other when such contracts are up for renewal, particularly when petitioner has been given no opportunity to amend his complaint.

REASONS FOR GRANTING THE WRIT.

A. The Decision of the First Circuit Involves Important Issues Regarding the Role of Derivative Suits in the Private Enforcement of Causes of Action Commenced Under the Federal Antitrust and Securities Laws.

This Court has repeatedly emphasized the importance of private enforcement of the antitrust and securities laws:

> ". . . the purposes of the antitrust laws are best served by insuring that the private action will be an ever-present threat to deter anyone contemplating business behavior in violation of the antitrust laws." *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U. S. 134, 139 (1968).

> "Congress has expressed its belief that private antitrust litigation is one of the surest weapons for effective enforcement of the antitrust laws." *Minnesota Mining & Mfg. Co. v. New Jersey Wood Finishing Co.*, 381 U. S. 311, 318 (1965).

Moreover, the role of *derivative* suits in the private enforcement of the antitrust and securities laws cannot be minimized:

> ". . . derivative suits have played a rather important role in protecting shareholders of corporations from the designing schemes and wiles of insiders who are willing to betray their company's interest in order to enrich themselves." *Surowitz v. Hilton Hotels Corp.*, 383 U. S. 363, 371 (1966).

> "Private enforcement of the proxy rules provides a necessary supplement to Commission action. As in antitrust treble damage litigation, the possibility of

civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements." *J. I. Case Co. v. Borak*, 377 U. S. 426, 432 (1964) (derivative suit).

Nowhere has the need for derivative suits been more evident than in the mutual fund industry.[7] As Hamer H. Budge, former chairman of the SEC, explained to Congress:

> "This pattern is commonly referred to as one of external management. It is the traditional way of doing things in the investment company field, but it is hard to conceive of anything like it anywhere else . . . Mutual funds just do not go out to buy advisory . . . services on the open market on the best terms they can get. They are generally tied to their advisers. *The adviser sets his price and, typically, the fund pays that price. The arm's-length bargaining element in the ordinary business relationship is completely lacking here.*
>
> "The structural arrangements found in this industry create an economic environment in which *normal market restraints on managerial compensation are conspicuous by their absence.* This is a situation in which insiders usually bargain with themselves. *In this type of system, legal controls are needed in order to do what normal market forces can be depended on to do elsewhere.*

* * *

7. The continuing congressional concern for the mutual fund industry was recently evidenced in the 1970 amendment to 15 U. S. C. § 80a-35 which imposed a standard of fiduciary duty on, *inter alia*, investment advisers and affiliated directors.

> ". . . whatever competition there has been in the industry has historically been for sales, and recently for performance, *but never for lower advisory fees . . .*" *Hearings, Mutual Fund Legislation of 1969*, Part 2 at pp. 855, 858. (Emphasis supplied.)

Accordingly, a decision which impairs the ability of mutual fund shareholders to enforce privately the antitrust and securities laws by derivative suits will immunize the mutual fund industry from the salutary proscriptions of the antitrust and securities laws.

B. The Decision of the First Circuit on the Director Demand Issue Conflicts With Decisions of This Court and With Decisions of Several Courts of Appeal.

As noted above, the First Circuit majority insisted on reviewing the merits of the case by drawing "a sharp distinction between a transaction completely undirected to a corporate purpose and one which, while perhaps vulnerable to criticism, is of a character that could be thought to serve the interests of the company." (App., p. A32.) It is clear, however, from this Court's decisions in *Smith v. Sperling*, 354 U. S. 91 (1957), and in *Delaware & Hudson Co. v. Albany & Susquehanna R. R.*, 213 U. S. 435 (1909), that the good faith of the directors in approving of or acquiescing in an allegedly illegal transaction, an issue going to the merits, cannot be used to attack the sufficiency of petitioner's allegations.

Thus, in excusing a demand upon directors in *Delaware & Hudson Co. v. Albany & Susquehanna R. R.*, this Court held that "the good faith of the directors need not be questioned" and that "The attitude of the directors need not be sinister. It may be sincere." 213 U. S. at 451; see also *Smith v. Sperling*, 354 U. S. at 96-97. Likewise, in *Smith v. Sperling*, this Court emphasized (354 U. S. at 95):

"The gist of the findings of the District Court is that since there was no fraud on the part of the directors in making the contracts but only an exercise of independent business judgment, the management was not antagonistic to the financial interests of the corporation. *That is an issue that goes to the merits,* not the question of jurisdiction. There will, of course, be antagonism between the stockholder and the management where the dominant officers and directors are guilty of fraud or misdeeds. *But wrongdoing in that sense is not the sole measure of antagonism. There is antagonism whenever the management is aligned against the stockholder and defends a course of conduct which he attacks.* The charge normally is cast in terms of fraud, breach of trust, *or illegality.*" (Emphasis supplied.)

Indeed, in *Smith v. Sperling,* this Court held that the district court's finding that "management would not have been disqualified 'from faithfully doing their duty' as officers and directors but that 'such a demand would have been futile'" satisfied the requirements of Rule 23(b), the predecessor to Rule 23.1. 354 U. S. at 94 n. 2.

Significantly, in his concurring opinion, Chief Judge Coffin rejected the majority's distinction, which "ha[d] not been so articulated in almost a century of derivative suit jurisprudence" (App., p. A37), and stated (App., p. A39):

"I also note that the management fee contracts are not attacked as simply ultra vires or as the product of mere negligence or even of 'unsound' or 'erroneous business judgment'. They are alleged to be illegal under federal antitrust laws. If I were to calibrate a scale to measure the impact of varying improprieties, I would rate such an allegation fairly high. I find it

> hard to imagine that a director, however unaffiliated, who had participated, or under these circumstances knowingly acquiesced, in a major transaction, albeit for a corporate purpose, would authorize a suit, effectively against himself, claiming that the transaction violated the federal antitrust laws. Even independent watchdogs cannot be thought ready to sign a confession of that magnitude."

In fact, the "sharp distinction" drawn by the First Circuit conflicts with decisions by Courts of Appeals in several circuits uniformly excusing a demand upon directors when it has been alleged—as petitioner had alleged and could have alleged even more specifically if necessary—that the allegedly illegal transactions were approved of or acquiesced in by a majority of a board of directors, *irrespective* of any inquiry into the good faith or sincerity of such majority. *Liboff v. Wolfson*, 437 F. 2d 121, 122 (5th Cir. 1971); *Meltzer v. Atlantic Research Corp.*, 330 F. 2d 946, 947-948 (4th Cir. 1964) *cert. denied* 379 U. S. 841 (1964); *DePinto v. Provident Security Life Ins. Co.*, 323 F. 2d 826, 830 (9th Cir. 1963) *cert. denied* 376 U. S. 950 (1964); *Cathedral Estates, Inc. v. Taft Realty Corp.*, 228 F. 2d 85, 88 (2d Cir. 1955).

The fallacious nature of the First Circuit majority's attempt to evaluate, at the pleading stage, the propriety *vel non* of determining compensation by a formula is made manifest by its statement that "[a] court sitting in Boston can take judicial notice that testamentary and indenture trustees are commonly compensated on a formula basis." (App., p. A33). However, unlike the testamentary and indenture trustees commonly compensated on a formula basis, *only* investment advisers are permitted to increase their management fees simply by selling additional mutual

fund shares. This singular fact permits investment advisers, unlike testamentary and indenture trustees, to increase their compensation even though sales of additional mutual fund shares add *nothing* to the value of the investments of mutual fund shareholders. As succinctly stated by former SEC chairman Budge:

> "It is important to bear in mind that a growth in fund assets resulting from net sales does not increase the value of the investor's share; it just increases the number of shares outstanding." *Hearings, Mutual Fund Amendments of 1969,* Part 1 at p. 235.

Moreover, petitioner has alleged much more than "mere approval of the corporate action, absent self-interest or other indication of bias." (App., pp. A31-A32). To the contrary, this is a case where petitioner has alleged that the very directors, who approved the illegal investment adviser contracts, have also participated in a *continuing* combination and conspiracy, one of the substantial terms of which was to refrain from competing for the business of investment advisers managing other mutual funds so long as such investment advisers did not compete for their business when their investment advisory contracts were up for renewal (App., pp. B8-B9). Likewise, the *continuing* approval by unaffiliated directors of allegedly illegal investment adviser contracts permitting investment advisers to charge and receive grossly excessive management fees can hardly be said to reflect an unbiased and open forum for petitioner's complaint. To the contrary, at the least it demonstrates the domination and control effectively exercised by the affiliated directors and investment advisers over the unaffiliated directors and the penchant of the latter to engage in business as usual.

The second reason for the First Circuit's decision[8] was its finding that petitioner had failed to allege that "the unaffiliated directors who would have voted on [petitioner's] demand in 1968, had he made one, were the same ones (and hence, assertedly, impervious to a demand) that composed the boards when the contracts in question were approved." (App., pp. A31 and A36-A37.)

Initially, it should be noted that any fair reading of petitioner's pleading reveals that petitioner alleged that the mutual funds *as entities* participated in the combination and conspiracy set forth with particularity in paragraphs 22 and 29 of the complaint (App., pp. B7-B9) and that *all* of the defendants, obviously including the mutual funds, acquiesced, encouraged, cooperated and assisted in the effectuation and maintenance of the price fixing and noncompetition as set forth in paragraph 30 of the complaint (App., p. B9). Significantly, the Court of Appeals' *own* recitation of petitioner's allegations *confirms* such a reading (App., pp. A26-A27).

The district court, however, concluded that, because of the rebuttable statutory presumption contained in 15 U. S. C. § 80a-2(a)(9) regarding the independence of unaffiliated directors, petitioner had not "shown adequate reason to excuse himself from making a demand on the boards of directors." (App., pp. A18-A19.) Furthermore, the district court held that petitioner had failed to comply with the strict Massachusetts rule regarding demand upon and approval by stockholders as a prerequisite to the maintenance of a derivative suit (App., pp. A9-A16). Accordingly, petitioner was left with *no* alternative but to appeal to the First Circuit. ***No amendment to his complaint could have overcome the district court's decision.***

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8. This was the only reason which Chief Judge Coffin agreed with in his concurring opinion (App., p. A36).

On appeal, the First Circuit rejected the district court's approach,[9] but agreed with its result. Holding that the word "particularity" in Rule 23.1 required precision in petitioner's pleading, the First Circuit held that petitioner's allegations regarding the complicity of the mutual funds were insufficiently particular.[10] In an effort to cure this alleged defect, petitioner filed an affidavit, with his petition for rehearing, demonstrating that, based on sworn statements filed by the four Kauffman funds with the SEC, the unaffiliated directors who would have voted on [petitioner's] demand, had he made one, were essentially the same ones that composed the boards not only when the contracts in question were approved but when they were renewed as well (App., pp. C1-C7).

Stating that there had been "ample time for [petitioner] to make its now proffered assertions," the First Circuit declined to accept the affidavit (other than for purposes of "identification") and refused to permit petitioner leave to amend his complaint[11] (App., p. A43). However, given the holding of the district court, the First Circuit's decision was the *first time* in three years that *any* court had held petitioner's pleading, *in and of itself*, deficient under Rule 23.1. Furthermore, *defendants*, not petitioner, had adopted the procedure of arguing their motions to dismiss *seriatim* and *defendants*, not petitioner, had delayed their Rule 23.1 motions until their *third* group of motions to dismiss.

In this context, it would be a manifest injustice to penalize petitioner for failing to request leave to amend his complaint at an earlier stage of these proceedings. In-

9. See App., pp. A27-A28.

10. See pp. 9-10, *supra*.

11. Although the First Circuit was willing to take judicial notice of the compensation received by testamentary and indenture trustees, it was apparently unwilling to take judicial notice of sworn facts contained in public documents filed with the SEC.

deed, "[i]t is too late in the day and entirely contrary to the spirit of the Federal Rules of Civil Procedure for decisions on the merits to be avoided on the basis of such mere technicalities. 'The Federal Rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits.'" *Foman v. Davis*, 371 U. S. 178, 181-182 (1962); see also *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U. S. 321, 334-335 (1971) and *Ballou v. General Electric Co.*, 393 F. 2d 398, 399-400 (1st Cir. 1968) ("In any event, it would have been necessary to give plaintiffs an opportunity to amend if this were merely a matter of deficient pleadings.") As this Court stated in *Surowitz* (383 U. S. at 373):

> "The basic purpose of the Federal Rules is to administer justice through fair trials, not through summary dismissals as necessary as they may be on occasion . . . *If rules of procedure work as they should in an honest and fair judicial system, they not only permit, but should as nearly as possible guarantee that bona fide complaints be carried to an adjudication on the merits.* Rule 23(b), like the other civil rules, was written to further, not defeat, the ends of justice." (Emphasis supplied.)

In light of this Court's holdings in *Foman* and *Surowitz*, the First Circuit's narrow and technical construction of Rule 23.1 improperly bars petitioner from an adjudication on the merits even though his complaint has *never* been attacked for failing to state a cause of action in any of defendants' three groups of motions to dismiss.

The third and last reason advanced by the First Circuit majority was its refusal to "infer collective hostility to [petitioner's] claims by dwelling on the fact that his

suit has met extended resistance" on the ground that such resistance was allegedly based on nonsubstantive grounds (App., p. A30). However, in *Smith v. Sperling*, a *derivative suit* based upon diversity jurisdiction [12] involving the question of alignment of parties, this Court considered the question of antagonism between a stockholder and the management of the corporation in which he owned stock. In words which apply with equal emphasis to the antagonism apparent where, as here, the directors have resisted the complaint for more than three years and have approved of and acquiesced in the contracts and course of conduct alleged to be illegal,[13] this Court stated (354 U. S. at 97):

> "Whenever the management refuses to take action to undo a business transaction or whenever, as in this case, it so solidly approves it that *any demand to rescind would be futile*, antagonism is evident. The cause of action, to be sure, is that of the corporation. But the corporation has become through its managers hostile and antagonistic to the enforcement of the claim." (Emphasis supplied.)

Thus, the distinction drawn by the First Circuit majority between substantive and nonsubstantive resistance is meaningless. The failure of the directors of the four Kauffman funds to pick up petitioner's cudgels in the preceding three years, wholly apart from their so-called nonsubstantive insistence on a demand, is plain proof that "the stockholder and those who manage the corporation are completely and irrevocably opposed on a matter of corporate practice and policy." *Smith v. Sperling*, 354 U. S. at 97.

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12. The KMF actions are based upon federal question jurisdiction.

13. See App., pp. B6-B9 and C1-C7, *infra*.

C. The Decision of the District Court on the Shareholder Demand Issue, Which Was Not Reached by the First Circuit, Conflicts With Decisions of This Court and With Decisions of Several Courts of Appeal.

1. State Law or Policy Cannot Be Applied to Nullify a Federal Cause of Action Arising Under the Federal Antitrust Laws.

The decision of the district court has produced the astonishing result that a complaint stating a federal cause of action under the federal antitrust laws has been dismissed against the two Kauffman funds incorporated in Massachusetts, but not against the two Kauffman funds incorporated in New York, *solely* because of a failure to comply with a unique and restrictive *state* policy which requires not only a demand upon stockholders but also their approval as a prerequisite to the commencement of a derivative suit. If permitted to stand, the right of shareholders to commence derivative suits under the Sherman Act will have been nullified not by congressional enactment but by a restrictive *state* policy.[14]

This Court has repeatedly indicated that, in the private enforcement of the antitrust laws, state law and policy must be disregarded. Thus, in *Sola Electric Co. v. Jefferson Electric Co.*, 317 U. S. 173, 176 (1942), this Court unanimously rejected a state common law rule under which a private antitrust litigant would have been estopped from challenging under the Sherman Act a licensing arrangement to which he had agreed, stating:

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14. "It is clearly established that 15 U. S. C. A. § 15 gives federal courts *exclusive* jurisdiction over federal antitrust actions." *Engelhardt v. Bell & Howell Co.*, 327 F. 2d 30, 35 (8th Cir. 1964) (emphasis supplied); *Cream Top Creamery v. Dean Milk Co.*, 383 F. 2d 358, 363 (6th Cir. 1967); *Banana Distributors, Inc. v. United Fruit Co.*, 269 F. 2d 790, 793 (2d Cir. 1959).

"It is familiar doctrine that the prohibition of a federal statute may not be set at naught, or its benefits denied, by state statutes or state common law rules. In such a case our decision is not controlled by *Erie R. Co. v. Tompkins*, 304 U. S. 64, 82 L. Ed. 1188, 58 S. Ct. 817, 114 ALR 1487. There we followed state law because it was the law to be applied in the federal courts. But the doctrine of that case is inapplicable to those areas of judicial decision within which the policy of law is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law. [Cases cited.] When a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted. *To the federal statute and policy, conflicting state law and policy must yield.* [Constitution and cases cited.]" (Emphasis supplied.)

Likewise, in *Perma Life Mufflers, Inc. v. International Parts Corp.*, a private antitrust action, this Court declared, "We have often indicated the inappropriateness of invoking broad common-law barriers to relief where a private suit serves important public purposes." 392 U. S. at 138-139.

The rationale of these cases is that private antitrust litigation should be encouraged since it serves the public interest by eliminating anticompetitive conduct and agreements. Because of the primacy of this public interest, this

Court has held that the Sherman Act *precludes* application of state laws or policies that would impair or vitiate a private litigant's ability to sue thereunder. By superimposing the strict Massachusetts stockholder demand requirement herein, the district court has in effect nullified the vigorous uniform enforcement of the federal antitrust laws.

The incongruity of engrafting the unique and restrictive Massachusetts requirement on the Sherman Act is self-evident. Even the district court recognized stockholders *cannot* ratify antitrust violations. *Rogers v. American Can Co.*, 305 F. 2d 297, 315 (3d Cir. 1962); *Gottesman v. General Motors Corp.*, 268 F. 2d 194, 197 (2d Cir. 1959). (App., p. A13.) Yet, application of the strict Massachusetts rule, as delineated in *S. Solomont & Sons Trust, Inc. v. New England Theatres Operating Corp.*, 326 Mass. 99, 111, 114, 93 N. E. 2d 241, 247, 249 (1950), would require petitioner to make a demand upon *and* secure the approval of a majority of the stockholders of the two Massachusetts funds prior to the commencement of any federal antitrust litigation. Significantly, under the *absolute* Massachusetts rule, a request for stockholder approval and their subsequent refusal is *insufficient; actual approval* must be secured in order to comply with the rule. 326 Mass. at 111, 114; 93 N. E. 2d at 247, 249. Thus, although federal doctrine prohibits ratification of antitrust violations by stockholders, petitioner's cause of action would survive only in limbo since the conflicting Massachusetts policy would require him to secure stockholder *approval* prior to commencing his action, an obviously futile and burdensome act given the tens of thousands of shareholders involved herein [15] and given petitioner's extremely limited access to

15. At the time in question, the two Kauffman funds incorporated in Massachusetts had 252,900 stockholders (Fidelity Trend Fund, Inc.) and 97,434 stockholders (The Putnam Growth Fund).

management proxy statements.[16] Accordingly, it is clear that the conflicting Massachusetts rule must yield to the federal antitrust laws.

2. A Stockholder's Right to Sue Derivatively on a Federal Cause of Action Is a Federal Right, the Effectiveness of Which Cannot Be Varied by the Whims and Vagaries of State Law.

Defendants contended below that the right of a stockholder to assert derivatively his corporation's rights depends on the law of the state of incorporation for his corporation. Thus, it was argued, a state could abolish the right to sue derivatively for violations of federal law or, as in the case of Massachusetts, a state could so severely restrict such right as to render it meaningless. *S. Solomont & Sons Trust, Inc. v. New England Theatres Operating Corp., supra; Pomerantz v. Clark*, 101 F. Supp. 341 (D. Mass. 1951) (diversity case).

This contention, when pressed in a federal question case as contrasted to a diversity case, has been rejected by every Court of Appeals that has considered it. In *McClure v. Borne Chemical Co., Inc.*, 292 F. 2d 824 (3d Cir. 1961) *cert. denied* 368 U. S. 939 (1961), the Third Circuit rejected arguments similar to those raised below by the two Massachusetts funds. There, the Court held that neither the Pennsylvania forum's security for costs statute nor the security for costs statute found in the corporation's state of incorporation (New Jersey) were applicable to *a federally created right, jurisdiction of which was vested*

16. Petitioner would be entitled to only a 100 word statement, Investment Company Act Rule 20a-1(a), 17 C. F. R. § 270.20a 1(a); Securities Exchange Act Rule 14a-8(b), 17 C. F. R. § 240.14a-8(b). "[A]ny contention that plaintiff could make full disclosure in a 100 word statement . . . and receive thoughtful and adequate consideration, would be unrealistic." *Levitt v. Johnson*, 334 F. 2d at 819 n.4.

exclusively in the federal courts. 292 F. 2d at 829-835. As the Third Circuit held in *McClure* (292 F. 2d at 830-831):

> "In the present case we are not dealing with congressional silence on limitations but silence on security for expenses. Unlike statutes of limitations, security statutes do not embody traditional principles of law which are universally accepted. There is sharp dispute as to their desirability and efficacy. Moreover, only a minority of our states have enacted such statutes. Under these circumstances a presumption that Congress intended that courts should imply a security requirement from a statute, granting an express or an implied private right of action seems unjustified. Congress cannot be presumed to have authorized the courts to engraft a unique and controversial limitation upon a statutory right through its silence on the subject of that limitation."

Similarly, Section 4 of the Clayton Act, 15 U. S. C. § 15, which expressly creates the private right of action under the Sherman Act herein, does not contain any language indicating a congressional intent to incorporate the absolute Massachusetts rule which, like security for costs statutes, is a "unique and controversial limitation" upon a stockholder's right to sue derivatively under the antitrust laws.[17]

Defendants' argument has also been considered and rejected by the Second Circuit. In *Fielding v. Allen*, 181 F. 2d 163 (2d Cir. 1950) *cert. denied* 340 U. S. 817 (1950), a plaintiff sued derivatively, alleging lack of compliance with a provision of the Interstate Commerce Act making it unlawful for a single company to control two or more carriers without Interstate Commerce Commission approval.

17. Petitioner has been unable to find another state which follows or applies a rule similar to the Massachusetts rule.

The question was whether the plaintiff was required to comply with a New York security for expenses requirement, a restriction similar to the strict Massachusetts stockholders' demand rule on a stockholder's right to sue on behalf of his corporation. The Court concluded that state law was *inapplicable* (181 F. 2d at 167-168):

> "If [the stockholder's] right to maintain this derivative action is one which he possesses only by virtue of state law, his suit may be subject to the condition which New York has imposed even though the corporate right is federal. This we need not decide, however, for we think that *the stockholder's right to maintain a derivative action on a corporate right federal in nature is federally conferred* . . ."
>
> • • •
>
> "Consequently, we think that *the right of a stockholder to sue on his corporation's federal cause of action is itself federal in nature* and therefore not subject to special requirements for cognate actions under state law." (Emphasis supplied.)

It should be emphasized that the cause of action in the current case, like the cause of action in *Fielding*, arises under a federal statute designed to promote competition.

Similarly, in *Drachman v. Harvey*, 453 F. 2d 722 (2d Cir. 1971) *rev'd on other grounds*, 453 F. 2d 736 (2d Cir. 1972) (*en banc*), the Court of Appeals declared (453 F. 2d at 728, 730):

> "The starting point in our analysis must be that appellants' derivative right of action to vindicate a federally created corporate right is one which is conferred solely by federal law. The remedial incidents of this

> federally created right must, of necessity, also be controlled by federal law, because the policy of uniformity within the federal system at least with respect to the issue at bar is paramount to any interests to be served by conformity with the variousness of state rules."
>
> • • •
>
> "Congress scarcely would have intended such an incongruous result, given the comprehensive statutory remedial scheme of the Exchange Act passed for the protection of investors, *nor would Congress have intended the creation of a broad remedial scheme, the effectiveness of which would be varied by the whims and vagaries of state law.*" (Footnotes omitted and emphasis supplied.)

To paraphrase the Second Circuit in *Drachman*, in enacting the Sherman Act, Congress scarcely could have intended the creation of a broad remedial scheme, the effectiveness of which could be varied by the whims and vagaries of a state law, such as the strict Massachusetts rule requiring demand upon and approval by shareholders as a precondition to the commencement of a derivative suit.

Finally, in *Levitt v. Johnson*, the First Circuit itself refused to apply the strict Massachusetts rule when it was proffered in the context of a case commenced under the Investment Company Act of 1940, stating (334 F. 2d at 819):

> "We do not see how it can be gainsaid that any substantial stiffening of the conditions precedent to the bringing of stockholders' suits above normal requirements would conflict with this broad declaration. The district court's reasoning that since the stockholder's

> right is a derivative one his right to bring suit must be controlled by the local law of the state of incorporation in the absence of an explicit congressional direction to the contrary negates the intendment of the act and underestimates the role to be played by the federal courts in the implementation of national regulatory legislation." [Footnote omitted.]

Likewise, in the case at bar, the strict Massachusetts rule negates the congressional intention embraced by the Sherman and Clayton Acts and undermines the exclusive role to be played by the federal courts in the uniform implementation of the federal antitrust laws.

3. Federal Law Excuses Stockholder Demand Where, as Here, It Would Be Unreasonable to Require It.

The district court, at defendants' urging, partially relied on this Court's decision in *United Copper Securities Co. v. Amalgamated Copper Co.*, 244 U. S. 261 (1917) in reaching its decision that stockholder demand was required herein. However, when read in its historical context, it is inescapably clear that this Court applied *federal* law in *United Copper*.

Rule 23.1 is a direct descendant of the rule enunciated in *Hawes v. Oakland*, 104 U. S. 450 (1882), which recognized, *inter alia*, that the requirement of demand upon shareholders is excused when "*it [is] not reasonable to require it.*" 104 U. S. at 461 (emphasis supplied). The *Hawes* rule was promptly adopted as Equity Rule 94 (104 U. S. IX) and has been continued in effect ever since, with only minor revisions, as Equity Rule 27 in 1913 (226 U. S. 629, 656), the original Rule 23(b), and now as Rule 23.1. Thus, Rule 23.1 today expresses the *federal policy* that the requirement of demand upon shareholders is

conditional, i.e., only "if necessary," and may be excused when *"it [is] not reasonable to require it."* *Hawes v. Oakland*, 104 U. S. at 461 (emphasis supplied).

The *United Copper* case was a derivative action brought by stockholders of United Copper Company alleging that certain individuals and corporations had, by conduct in violation of the Sherman Act, injured United Copper Company. Neither the directors of United Copper nor the company itself were alleged to have participated in the alleged violations. The complaint alleged that demand had been made upon the company to bring the action, but the company had refused to do so.

Although it concluded that a demand should have been made on the stockholders to bring the suit under the particular circumstances of that case, this Court expressly recognized the continuing vitality of the *Hawes* rule in *United Copper* (244 U. S. at 264):

> "In the instant case there is no allegation that the United Copper Company is *in the control of the alleged wrongdoers*, or that its directors stand in any relations to them, or that *they have been guilty of any misconduct whatsoever* . . . No application appears to have been made to the stockholders as a body, or indeed to any other stockholders individually; nor does it appear that there was no opportunity to make it, *and no special facts are shown which render such application unnecessary.*" (Emphasis supplied.)

This Court did not even mention state laws, rules or decisions and did not even discuss the law of the state of incorporation of United Copper Company. On the contrary, in light of its decision in *Hawes*, the recodification of the *Hawes* rule as Equity Rule 27 just *four years earlier in 1913*, 226 U. S. at 656, and the then prevailing federal

common law doctrine of *Swift v. Tyson*, 16 Pet. 1 (1842), it is clear beyond peradventure that this Court applied federal law in *United Copper*.

In essence, *United Copper* merely stands for the proposition that the Sherman Act does not modify the *federal* rule regarding the necessity or lack thereof for shareholder demand. Unlike the strict Massachusetts rule, however, the federal rule, as first enunciated in *Hawes*, as first codified in 1882, as recodified in 1913, as enunciated again in 1917 in *United Copper* and as presently codified in Rule 23.1, is a *conditional* rule which excuses stockholder demand where "it [is] not reasonable to require it," where the wrongdoers are in control of the company or where facts are shown which render it unnecessary. *Hawes v. Oakland*, 104 U. S. at 461; *United Copper Securities Co. v. Amalgamated Copper Co.*, 244 U. S. at 264; Rule 23.1, Fed. R. Civ. P.

If the district court's decision were permitted to stand, it effectively would nullify the right of any shareholder of any Massachusetts corporation to commence a derivative action for violations of the Sherman Act. Given the exegesis of Rule 23.1, this Court's decisions in *Sola Electric* and *Perma Life*, the First Circuit's decision in *Levitt*, the Second Circuit's decisions in *Fielding* and *Drachman* and the Third Circuit's decision in *McClure*, such a vitiation of the uniform and vigorous enforcement of national antitrust policy cannot be countenanced by this Court.

CONCLUSION.

In *Surowitz*, this Court wrote that "Rule 23(b) [the predecessor to Rule 23.1] . . . was written to further, not defeat, the ends of justice." 383 U. S. at 373. If the First

Circuit's decision is permitted to stand in the case at bar, Rule 23.1 will have been used to promote, rather than prevent, a manifest injustice.

For the foregoing reasons, it is respectfully submitted that this Court should grant the Petition for a Writ of Certiorari to review the judgment of the Court of Appeals for the First Circuit.

Respectfully submitted,

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CERTIFICATE OF SERVICE.

I hereby certify that on this 11th day of July, 1973, three copies of the Petition for a Writ of Certiorari were served, by first class mail, postage prepaid, on each of the attorneys listed on Master List R-7, the official service list prepared by defendants' counsel. I further certify that all parties required to be served have been served.

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Appendix.

DISTRICT COURT OF THE UNITED STATES
FOR THE DISTRICT OF MASSACHUSETTS.

MDL—78.
(ALL CASES.)

IN RE
KMF ACTIONS

OPINION.

June 7, 1972.

PETTINE, *J.*

Important questions of law are raised by several motions to dismiss in this complex and far-reaching litigation.

Plaintiff, a shareholder in four mutual funds,[1] has sued sixty-five mutual funds; thirty-eight investment advisors managing these funds; thirty-seven directors, alleged to be affiliated with the advisors and to be self dealing; and the Investment Company Institute, the trade association representative for the mutual fund industry. The complaint

1. The Dreyfus Fund, Inc.; Fidelity Trend Fund, Inc.; Manhattan Fund, Inc.; and The Putnam Growth Fund. It is these four funds that are referred to later as "the Kauffman funds." The remaining fund defendants other than the Kauffman funds are referred to as the non-Kauffman fund defendants.

consists of three counts;[2] only Count I is pertinent here. Count I alleges that all defendants had agreed, combined and conspired to fix and adopt similar schedules of grossly excessive management fees and to refrain from competing for the business of mutual funds and the business of investment advisors in violation of federal antitrust laws.

A decision by the Third Circuit Court of Appeals, *Kauffman v. Dreyfus Fund, Inc.*, 434 F. 2d 727 (3rd Cir. 1970), pruned down to one the original several capacities in which plaintiff sought to pursue this action. Plaintiff was allowed to maintain this action only in his capacity as a shareholder suing derivatively on behalf of the four mutual funds in which he owns shares. *Kauffman v. Dreyfus Fund, Inc.*, 434 F. 2d at 738.

Count I of the action as to all defendants was transferred to this Court by the Judicial Panel on Multidistrict Litigation for pre-trial proceedings.

Defendants have made various motions to dismiss. The four Kauffman fund defendants have moved under Rule 23.1, Fed. R. Civ. P., to dismiss for (1) failure of plaintiff to make demand on the directors of the Kauffman funds that they institute this action and (2) failure of plaintiff to fairly and adequately protect the interests of those he represents, or, alternatively, to strike the appearances of plaintiff's counsel. Two of the Kauffman fund defendants, the Putnam Growth Fund and Fidelity Trend Fund, move to dismiss under Rule 23.1, Fed. R. Civ. P., for failure of plaintiff to make demand on their shareholders to institute this action. The non-Kauffman fund defendants move to dismiss for failure to state a claim against them upon which relief may be granted. The motions will be discussed separately.

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2. Count II alleges violations of the Investment Company Act of 1940, 15 U. S. C. § 80a-1 et seq.

Count III alleges violations of the Securities Exchange Act of 1934, 15 U. S. C. § 78n, the Investment Advisers Act of 1940, 15 U. S. C. § 80b-6, and the Investment Company Act, *supra*.

1. Non-Kauffman Fund Defendants' Motion to Dismiss.

The non-Kauffman fund defendants (listed on Schedule A) have moved to dismiss the action against them on the ground that plaintiff has failed to state or has waived any claims upon which relief can be granted. The motion is made pursuant to Rule 12(b)(6), Rule 12(c), and Rule 56 of the Federal Rules of Civil Procedure. The non-Kauffman fund defendants argue that they are not necessary parties to any relief properly sought on behalf of the Kauffman fund defendants.

Having been limited by the Third Circuit Court of Appeals to pursuing this suit as a derivative action, plaintiff has sued the non-Kauffman funds, their investment advisors and directors on behalf of the Kauffman funds. While plaintiff seeks monetary damages from other defendants, he seeks only injunctive relief against the non-Kauffman fund defendants. Such injunctive relief is sought "enjoining and restraining defendants from continuing to pay or receive grossly excessive management fees or fees calculated solely on the basis of the average net assets of any of their externally managed mutual funds." It is argued that injunctive relief is necessary against the funds to restrain "involuntary conduct forced upon them by the self-dealing directors and the investment advisors who have dominated and controlled them and their personnel."

This being the plaintiff's theory, the non-Kauffman fund defendants argue, then they are but mere pawns manipulated by others and injunctive relief is properly sought against the manipulators, not the pawns. The interests of the Kauffman funds, they argue, are not furthered by seeking injunctive relief against the victims, the non-Kauffman funds. The true interest being asserted by plaintiff in his attempt to seek injunctive relief against them, they argue, is in protecting them from their manipulators,

not in protecting the Kauffman funds. Declining to avail themselves of plaintiff's magnanimous veil of protection which retains them in this lawsuit, they argue that plaintiff is foreclosed from attempting to protect the non-Kauffman funds' interests by the decision of the Third Circuit which limited plaintiff to suing derivatively only on behalf of those funds in which he held shares. Thus, they argue, it is inequitable to retain them as parties and the action as to them should be dismissed.

It is, of course, well within plaintiff's rights in an antitrust case to select his remedies to seek injunctive relief without seeking monetary damages. 15 U. S. C. § 26; see *Hawaii v. Standard Oil Company of California*, 40 U. S. L. W. 4246 (U. S. March 1, 1972).

Neither victims of fate nor innocent of their circumstances, these defendants argue disingenuously. Plaintiff's request for injunctive relief against them is not an overreaching attempt to protect the non-Kauffman funds but rather an attempt to insure the practical effect of any judgment in favor of the Kauffman funds. As plaintiff has argued, a competitive market would not necessarily be opened up in the mutual fund industry if the defendant advisors and directors ceased antitrust violations as to the Kauffman funds while the non-Kauffman funds continued to passively accept the fixing of management fees. Furthermore, investment advisors may be changed, see e.g. *Rosenfeld v. Black*, 445 F. 2d 1337 (2d Cir. 1971), as may directors, and it is not unreasonable to seek relief from the funds themselves to protect against dilution of the injunctive relief by substitution of new *dramatis personae* among the other defendants. Should it be proven that there is a pattern of failure on the part of the independent directors to insure that the bargaining of the advisory contracts is done at arms length and that such a pattern has led to the antitrust violations, injunctive relief against

the funds would prod these directors. The effect of limited competition in the business of providing investment advisory services may be to damage the Kauffman funds.

Whether or not plaintiff has suffered actual injury, injunctive relief is available on a showing of significant threat of injury from an impending violation of the antitrust laws or from a continuing violation likely to recur. *Zenith Corp. v. Hazeltine*, 395 U. S. 100, 130 (1969).

Affidavits having been submitted to this Court in connection with this motion, the motion is treated as one for summary judgment pursuant to Rule 56. Rule 12(b)(6), Fed. R. Civ. P. In light of plaintiff's allegations that a conspiracy in restraint of trade exists, I am unable to find that there is no genuine issue as to any material fact. "[S]ummary procedures should be used sparingly in complex antitrust litigation where motive and intent play leading roles, the proof is largely in the hands of the alleged conspirators, and hostile witnesses thicken the plot." *Poller v. Columbia Broadcasting System*, 368 U. S. 464, 473, quoted in *Norfolk Monument v. Woodlawn*, 394 U. S. 700, 704 (1969). Nor am I able to say that no set of facts exist which would support a claim for the relief requested here.

The motion to dismiss under Rules 12(b)(6); 12(c); and 56 is denied.

2. Motion of Kauffman Fund Defendants to Dismiss or to Strike Appearances of Plaintiff's Counsel.

The four Kauffman fund defendants, that is, The Dreyfus Fund, Inc.; Fidelity Trend Fund, Inc.; Manhattan Fund, Inc.; and the Putnam Growth Fund, have moved to dismiss the complaint for failure of plaintiff to comply with the requirement of fair and adequate representation under Rule 23.1, Fed. R. Civ. P. They also move to strike

the appearances of plaintiff's attorneys because of their "disabling conflict of interests."

Rule 23.1 provides in relevant part:

> "The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association."

Shareholders who bring derivative actions are, defendants argue, in the position of trustees for the corporation and thus have a fiduciary obligation to the corporation. In relinquishing his claim to damages from all of the funds, including the Kauffman funds, plaintiff has, they argue, breached his fiduciary duty to "maximize the chances of recovery of those whom he [has] undertaken to represent."

Plaintiff argues that these motions are foreclosed by the law of the case as established in the District Court of New Jersey and the Third Circuit Court of Appeals. Even if these motions are not foreclosed, plaintiff argues, they are without merit and premature.

The Law of the Case.

Plaintiff has argued that defendants were required to submit all motions attacking standing in the District Court for the District of New Jersey, that these motions should have been made then, that they were not made at that time and so have been waived. "Standing," like "jurisdiction," is a much encompassing concept. In the context of the history of this litigation, I find no waiver.

As to whether the law of the case bars defendants from raising this claim of conflict of interest, I find that it does not. The opinion of the Third Circuit Court of Appeals in *Kauffman v. Dreyfus Fund, Inc.*, 434 F. 2d 727, is restricted to those issues certified to it by the District

Court, see 51 F. R. D. 18. This particular claim of conflict of interest was not among the certified questions. For these reasons I turn to the Rule 23.1 issues.

Fair and Adequate Representation.

Plaintiff has fulfilled his duty of fair and adequate representation of the interests of similarly situated shareholders. Regardless of whether plaintiff has relinquished his claim for damages against defendant funds or in fact never asserted such claims, he is under no obligation to seek all available remedies at law and in equity.

Although the analogy to the law of torts is not entirely persuasive, it is instructive. There, a plaintiff is not obliged to sue all wrongdoers from the outset, and, in cases such as those involving abatable nuisances, a plaintiff may seek injunctive relief as a cause of action separate from an action for damages, see *Lawlor v. National Screen Service Corporation,* 349 U. S. 322, 327-28, n. 13 (1955).

It would be a perversion of the purpose of Rule 23.1 to read it, as defendants do, to require that all available remedies be sought by the plaintiff shareholder. Rule 23.1 does not impose upon the plaintiff shareholder the obligation to champion his company's cause against every and all wrongdoers. While the history of this clause of Rule 23.1 is scant and unenlightening, see *Shulman v. Ritzenberg,* 47 F. R. D. 202, 210-211 (D. D. C. 1969), it would appear that the Rule seeks to protect against collusive suits or situations where the plaintiff's interests are antagonistic to those of similarly situated shareholders, see 7 C. Wright and A. Miller, Federal Practice and Procedure, § 1765 (1972). There is no argument here of collusion or that the relief sought is detrimental to the interests of the shareholders, only that a further claim for relief in the form of damages should be made. The situation at bar is not one of plaintiff seeking a form of relief in itself detrimental to the best interests

of other shareholders, see *Maynard, Merel & Co. v. Carciopolo*, 51 F. R. D. 273 (S. D. N. Y. 1970), or of plaintiff pursuing this action for ends extraneous to the complaint and antagonistic to the interests of other shareholders, see *Nolen v. Shaw-Walker Company*, 449 F. 2d 506 (6th Cir. 1971).

Contrary to defendants' contentions, it may be that plaintiff has decided that the interests of the shareholders would best be furthered by not pursuing a claim for damages against the defendant funds. It may be that, in the assessment of plaintiff's counsel, the effort to be expended in pursuing such a claim would either not be repaid by an award of damages, or would result in a nominal award. The enormous legal costs and counsel fees thus needlessly accumulated might well be paid out of the award fund and so reduce the amount of the actual award to the Kauffman funds. See *Schectman v. Wolfson*, 244 F. 2d 537 (2d Cir. 1957).

While the transposition of legal concepts should be approached cautiously, in accepting defendants' argument that a shareholder derivative plaintiff is a trustee with fiduciary obligations to the corporation, I would point out that a fiduciary does not usually have a duty to maximize returns, but rather a duty to engage in a course of prudent investment. 54 Am. Jur. Trusts § 414.

The framing of plaintiff's case to seek injunctive relief rather than damages against the defendant funds does not work a hardship on similarly situated shareholders sufficient to invoke dismissal under Rule 23.1. It is doubtful whether either the Kauffman funds or later shareholder derivative plaintiffs would be precluded from seeking damages against mutual fund defendants on the mere fact that here plaintiff seeks only injunctive relief by the doctrines of *res judicata* and collateral estoppel. See *Lawlor v. National Screen Service Corporation, supra.*

For these reasons I cannot accept defendants' contention that plaintiff's "relinquishment" of a damages claim illustrates sufficient conflict of interest on the part of plaintiff's counsel to warrant striking their appearances from the record. Defendants would have plaintiff in a "damned if he does and damned if he doesn't" position. The motion to dismiss is denied; the motion to strike the appearances of plaintiff's counsel is denied.

3. Motions of the Kauffman Fund Defendants to Dismiss for Failure to Make Demand on Directors and on Shareholders.

Failure to Make Demand on Shareholders.

Two of the Kauffman fund defendants, The Putnam Growth Fund (Putnam Growth) and Fidelity Trend Fund, Inc. (Fidelity Trend), move to dismiss on the ground that plaintiff has failed to make demand on their shareholders in accordance with Rule 23.1, Fed. R. Civ. P. Rule 23.1 provides that

> "the complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires . . . , *if necessary*, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort."

Putnam Growth and Fidelity Trend argue that general federal law is silent and therefore the issue of whether demand on shareholders is "necessary" must be decided by reference to state law. The law of the state of incorporation, they argue, governs. Putnam Growth, a voluntary association, was organized in Massachusetts as a Massachusetts business trust; Fidelity Trend was incorporated in Massachusetts. Massachusetts follows a strict shareholder demand rule, waiving the requirement only when plaintiff

can show that a majority of the voting stock is controlled by the alleged wrongdoers. *S. Solomont & Sons Trust, Inc. v. New England Theatres Operating Corp.*, 326 Mass. 99, 114, 93 N. E. 2d 241, 249 (1950). Demand on the shareholders is required even when the shareholders lack power to ratify the wrong.

Massachusetts law governs this issue, they argue, even though a federal cause of action based on the federal antitrust laws is asserted. They rely on *United Copper Securities Company v. Amalgamated Copper Company*, 244 U. S. 261 (1917). *United Copper* involved a shareholders derivative action claiming that the company was damaged by conduct of others in violation of the Sherman Act. *United Copper*, decided before *Erie R. R. v. Tompkins*, 304 U. S. 64 (1938), sustained dismissal of the action:

> "The case involves, therefore, this single question: Whether a stockholder in a corporation which is alleged to have a cause of action in damages against others for conduct in violation of the Sherman Act may sue at law to recover such damages in the right of the corporation if, after request, it refuses to institute the suit itself? Insuperable obstacles to the maintenance of the action are presented both by the substantive law and by the law of procedure.
>
> Whether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management, and is left to the discretion of the directors, in the absence of instruction by vote of the stockholders. Courts interfere seldom to control such discretion intra vires the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation

which prevents an unprejudiced exercise of judgment; and, as a rule, only after application to the stockholders, unless it appears that there was no opportunity for such application, that such application would be futile (as where the wrongdoers control the corporation), or that the delay involved would defeat recovery. In the instant case there is no allegation that the United Copper Company is in the control of the alleged wrongdoers, or that its directors stand in any relations to them, or that they have been guilty of any misconduct whatsoever. Nor is there even an allegation that their action in refusing to bring such suit is unwise. No application appears to have been made to the stockholders as a body, or indeed to any other stockholders individually; nor does it appear that there was no opportunity to make it, and no special facts are shown which render such application unnecessary. For aught that appears, the course pursued by the directors has the approval of all the stockholders except the plaintiffs. The fact that the cause of action is based on the Sherman Law does not limit the discretion of the directors or the power of the body of stockholders; nor does it give to individual shareholders the right to interfere with the internal management of the corporation." 244 U. S. at 264.

Because the complaint fails to set forth efforts by plaintiff to apply to the shareholders, or reasons for not making such application, Putnam Growth and Fidelity Trend argue that the complaint should be dismissed as to them.

Plaintiff responds that the issue of demand on shareholders is to be decided as a matter of federal law; that the policies of the federal antitrust laws would be hindered or defeated by application of the state rule; and that, to the extent that *United Copper* dictates dismissal of this

action, federal law has evolved beyond it. Plaintiff points to the incongruity of applying the Massachusetts rule to result in dismissal of the action against the two Massachusetts funds and not dismissing as to the other two Kauffman funds, which are New York funds, even though "plaintiff has stated an identical cause of action based upon identical facts under the federal antitrust laws over which federal courts have exclusive jurisdiction." Plaintiff also argues that these defendants have waived their right to make this motion. It does not appear to this Court that defendants have waived the right to make this motion.

Defendants have not argued that this Court must apply state law under compulsion of *Erie R. R. v. Tompkins*, 304 U. S. 64. It is, of course, true that the fact that this action is not brought as a diversity action does not necessarily dispose of the *Erie* problems. The *Erie* doctrine applies, whatever the ground for federal jurisdiction, to any issue or claim which has its source in state law. *Maternally Yours v. Your Maternity Shop*, 234 F. 2d 538, 540-41 n.1 (2d Cir. 1956). In constitutional terms, I think it is clear that *Erie* does not mandate application of state law here inasmuch as this issue is within the legislative competence of the Congress.[3] See Friendly, In Praise of Erie—And of the New Federal Common Law, 39 N. Y. U. L. Rev. 383.

Defendants have argued that this is like the question of the statute of limitations applicable to private antitrust actions, which the Supreme Court has held is "left to the local law by the silence of the Statutes of the United States." *Chattanooga Foundry & Pipe Works v. Atlanta*, 203 U. S. 390, 397 (1906). See also *Leh v. General Petroleum Corporation*, 330 F. 2d 288 (9th Cir. 1964). This view comports with the insight of Professors Hart and Wechsler

3. That the Congress is empowered to affect "the discretion of the directors" and "the power of the body of shareholders," see *United Copper, supra*, here follows from *Levitt v. Johnson*, 334 F. 2d 815 and *J. I. Case Co. v. Borak*, 377 U. S. 426 (1964).

that "[f]ederal law is generally interstitial in its nature."[4] Our problem, however, is specifically with the meaning and application of Rule 23.1, Fed. R. Civ. P.

Rule 23.1, Fed. R. Civ. P., requires demand upon shareholders "if necessary." One commentator has considered the meaning of "if necessary" to be:

> "This reservation is inserted since a demand upon the shareholders, unlike the demand upon the directors, is intertwined with the substantive law of corporations dealing with the power of shareholders to ratify 'fraud.'"
>
> J. Moore, 3B Federal Practice, paragraph 23.1.19.

While shareholders would seem to lack power to ratify away a violation of the antitrust laws, *Rogers v. American Can Co.*, 187 F. Supp. 532 (D. N. J. 1960), aff'd 305 F. 2d 297 (3rd Cir. 1962), it is clear that under Massachusetts law demand must be made even when shareholders lack authority to ratify the alleged wrong. It has been held that a federal court sitting in diversity on a cause of action arising under state law must apply the strict Massachusetts rule. *Pomerantz v. Clark*, 101 F. Supp. 341, 345-46 (D.

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4. "Federal law is generally interstitial in its nature. It rarely occupies a legal field completely, totally excluding all participation by the legal systems of the states. This was plainly true in the beginning when the federal legislative product (including the Constitution) was extremely small. It is significantly true today, despite the volume of Congressional enactments, and even within areas where Congress has been very active. Federal legislation, on the whole, has been conceived and drafted on an ad hoc basis to accomplish limited objectives. It builds upon legal relationships established by the states, altering or supplanting them only so far as necessary for the special purpose. Congress acts, in short, against the background of the total corpus juris of the states in much the way that a state legislature acts against the background of the common law, assumed to govern unless changed by legislation."

H. Hart and H. Wechsler, The Federal Courts and the Federal System 435 (1953).

Mass. 1951). Thus, it would appear that Rule 23.1, Fed. R. Civ. P. does not in and of itself establish as a rule of federal law that shareholder demand is not required for a non-ratifiable wrong.

As reasoned by Judge Wyzanski in *Pomerantz v. Clark, supra,* one purpose of the demand on shareholders requirement is to provide an opportunity for a *majority* of shareholders to bring derivative suit against the majority of the directors. This purpose was recognized in *Halprin v. Babbitt,* 303 F. 2d 138, 141 (1st Cir. 1962), as was the purpose of allowing the majority to decide to take no action at all.

The First Circuit Court of Appeals has reasoned:

> "Neither of the more limited purposes we outlined in Halprin could be accomplished in any real sense unless the demand evoked a full and fair consideration of the issues, in depth, by the other stockholders. If their number is small, as in Halprin, and the minority could reasonably be expected to put its case before them, it should be obliged to do so. However, on the allegations of the present complaint not only would such a burden be enormous, but no disclosure that plaintiff could be expected to make would be likely to persuade a majority to take over the action, or, conversely, permit an informed decision by the majority that the action be not instituted.
>
> As a pointless or, alternatively, impossibly burdensome act it should be excused."

Levitt v. Johnson, 334 F. 2d 815, 818 (1st Cir. 1964).

The same reasoning might apply here for two reasons. First, Fidelity Trend and Putnam Growth had, plaintiff alleges, 252,900 and 97,432 shareholders as of December 31, 1967. This exceeds the 48,000 in *Levitt,* which number

the Court felt was too large to reasonably require demand on the shareholders. Second, the allegations of the complaint in *Levitt* were summarized as claims of charging of improper and excessive fees in a mutual fund, 334 F. 2d 815 at 817, as the complaint alleges here. The burden of disclosure sufficient to allow the majority of shareholders to make an informed decision is enormous here as in *Levitt*.

Levitt was a derivative suit on behalf of shareholders of a Massachusetts mutual fund alleging violations of the Investment Company Act of 1940, 15 U. S. C. §§ 80a-1 et seq. The alleged conduct in violation consisted of the charging of improper and excessive fees. *Levitt* held that in view of the national policy of securities regulation embodied in the Investment Company Act, the application of a strict shareholder demand rule which negated this policy was, as a matter of federal law, forbidden.

Levitt, might, then, be thought to argue for excuse of the shareholder demand requirement here. However, *Levitt* expressly distinguished cases involving alleged violations of the antitrust laws:

> "United Copper Securities v. Amalgamated Copper Co., supra, held that the fact that the cause of action was based upon an alleged violation of the Sherman Act did not obviate, or reduce, the necessity of a demand by the minority stockholders. This is a quite different situation. As the SEC points out in its amicus brief filed herein in opposition to the 'Massachusetts rule,' there is a 'great difference between the policy underlying the federal antitrust laws and that underlying the Investment Company Act. On the one hand, the policy of the antitrust laws is the preservation and protection of competition in our economy in its broadest scope. Those laws are thus geared to the protection of competing businesses, as businesses, whether in the

> corporate form or not. On the other hand, the policy of the Investment Company Act is to provide a comprehensive network of restrictions upon the organization, operation and management of investment companies to the end that individual investors might be protected.' "
>
> 334 F. 2d at 820 n.5.

Bound to follow the mandate of the circuit court, I feel I must, on the basis of this footnote 5 in *Levitt*, grant the motion to dismiss.

Failure to Make Demand on Directors.

The four Kauffman fund defendants move to dismiss on the ground that the complaint does not set forth with particularity the efforts made by plaintiff to obtain the desired action from the Kauffman fund directors or the reasons for not making efforts. Rule 23.1, Fed. R. Civ. P. provides, in pertinent part:

> "The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the actions he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort."

The allegations of the complaint relevant here are as follows:

> "10. Demand by plaintiff that defendant externally managed mutual funds or any other externally managed mutual funds affiliated therewith or related thereto bring this action would have been futile and, therefore, was not made.
>
> • • •

"23. At all times material to the Complaint:

(a) the self-dealing and affiliated directors and their respective investment advisers have dominated and controlled their respective externally managed mutual funds and their personnel, policies and boards of directors; and

(b) the self dealing and affiliated directors have dominated and controlled their respective investment advisers and their personnel, policies and boards of directors.

"24. At all times material to the Complaint, the contracts and other forms of agreement between the defendant investment advisers and their respective externally managed mutual funds have not been either the subject or the result of arm's-length bargaining between them.

"25. Pursuant to said contracts and other forms of agreement, defendant investment advisers receive for their respective investment advisory and management services a fee calculated solely on the basis of their respective mutual funds' average net assets ('management fees')."

Kauffman defendants argue that the allegations of the complaint are insufficient, being mere empty conclusions. The lack of substance in such conclusions, they argue, is demonstrated, *inter alia*, by the fact that at the time of the complaint, federal law provided that at least 40% of the board of any investment company should be composed of independent directors. Investment Company Act of 1940, Section 10(a), 15 U. S. C. § 80a-10(a). Such independent directors, they argue, cannot as a matter of law be presumed to be "controlled," Investment Company Act of 1940, Section 2(a)(9), 15 U. S. C. § 80a-2(a)(9), and should

have been allowed to consider a demand by plaintiff to take action. They also argue certain policy reasons for strict enforcement of the director demand requirement. See Note, *Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit,* 73 Harv. L. Rev. 746 (1960).

Plaintiff answers that due to their posture in prior proceedings in this case, the Kauffman fund defendants have waived their right to make this motion and that, in any event, plaintiff, under federal law, has satisfied Rule 23.1.

Concluding that there has been no waiver, this Court looks to the substance of the Rule 23.1 claim.

This case presents the intersection of the rule that a complaint should not be dismissed "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief," *Conley v. Gibson,* 355 U. S. 41, 45-46 (1957), with the requirements of Rule 23.1, Fed. R. Civ. P., that the complaint allege with particularity plaintiff's reasons for not making demand on directors.

Plaintiff has alleged that such demand would be futile because "the self-dealing and affiliated directors and their respective investment advisors have dominated and controlled their respective externally managed mutual funds and boards of directors." If Rule 23.1 is to be more than a nicety of pleading and is to safeguard corporations from abuse, see Note, *Demand on Directors and Shareholders as a Prerequisite to a Derivative Suit,* 73 Harv. L. Rev. 746 (1960), it must mandate that there be some merit to allegations of "futility" of demand. Plaintiff has not sufficiently shown the merits of his allegations of futility. Cf. *Meltzer v. Atlantic Research Corp.,* 330 F. 2d 946 (4th Cir. 1964).

As defendants have argued by attested affidavits, the majority of each of the boards of directors of the Kauff-

man funds is composed of non-affiliated directors. The complaint does not charge these "independent" directors with specific misconduct, as it does the affiliated directors. It rather alleges that these non-affiliated directors are "controlled." In light of an express statutory presumption contained in the Investment Company Act of 1940, 15 U. S. C. § 80a-2(a)(9) that "[a] natural person shall be presumed not to be a controlled person within the meaning of this subchapter," I do not find that plaintiff has shown adequate reason to excuse himself from making demand on the boards of directors. This is not a case where the majority of the board of directors are the accused wrongdoers. While the utility of independent directors has been criticized, see e.g. Nutt, A Study of Mutual Fund Independent Directors, 120 U. Pa. L. Rev. 179, 184-185 (1971), I cannot assume that the non-affiliated directors of these particular funds have been lax in their duties or that appeal to the majority of the boards would be "futile."

The motion to dismiss of the four Kauffman funds for failure to make demand on directors is granted. Defendants shall prepare an order reflecting these rulings.

RAYMOND J. PETTINE,
Raymond J. Pettine,
Chief Judge,
United States District Court, R. I.

UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF MASSACHUSETTS.

MDL-78
(ALL CASES)

IN RE
KMF ACTIONS.

ORDER.

Pursuant to paragraph 14 of Pre-Trial Order No. 1, paragraphs 4, 5 and 6 of Pre-Trial Order No. 2 and the Court's Notice of Pre-Trial Conference scheduled for May 12, 1972, and issued by the Clerk of the Court under date of April 11, 1972, a second formal pre-trial conference was held in the above-captioned cause on May 12, 1972. As a result thereof, and this Court having received briefs in support and in opposition to the motions hereinafter described, and having heard the oral arguments of counsel thereon, for the reasons set forth in the Opinion of this Court, dated June 7, 1972, it is hereby

ORDERED that:

1. The motion of defendants The Dreyfus Fund, Inc., Fidelity Trend Fund, Inc., Manhattan Fund, Inc., The Putnam Growth Fund and those listed on Schedule A attached to such motion pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure to dismiss the complaint for failure to state a cause of action on the ground that the complaint does not allege with particularity the efforts made by plaintiff to obtain the action that he desires from their directors or comparable authority and the reasons

for his failure to obtain such action or his failure to make such efforts, as required in derivative actions by a shareholder under Rule 23.1 of the Federal Rules of Civil Procedure, be and the same hereby is granted.

2. The motion of defendants Fidelity Trend Fund, Inc., The Putnam Growth Fund and those listed on Schedule A attached to such motion to dismiss the complaint as to them, on the ground that plaintiff has failed to state a cause of action inasmuch as the complaint does not allege with particularity in accordance with Rule 23.1 of the Federal Rules of Civil Procedure plaintiff's efforts to obtain the action he desires from their shareholders, be and the same hereby is granted.

3. The motion filed by the Fund Coordinating Committee and defendants listed on Schedule A attached to such motion pursuant to Rule 12(b)(6), 12(c), and 56, of the Federal Rules of Civil Procedure to dismiss the complaint, as modified by (a) the Opinion of the Court of Appeals for the Third Circuit (*Kauffman v. The Dreyfus Fund, Inc.*, 434 F. 2d 727), and (b) the subsequent Orders of the United States District Court for the District of New Jersey on the ground that plaintiff has failed to state or has waived any claims upon which relief can be granted, be and the same hereby is denied.

4. The motion of defendants The Dreyfus Fund, Inc., Fidelity Trend Fund, Inc., Manhattan Fund, Inc. and The Putnam Growth Fund and those listed on Schedule A attached to such motion pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure:

A. To dismiss the complaint for failure by the plaintiff to comply with his duty under Rule 23.1 of the Federal Rules of Civil Procedure fairly and adequately to represent the interests he purports to represent; and

B. To strike from the record the appearances of plaintiff's attorneys because of their disabling conflict of interests,

be and the same hereby is denied.

5. The cause be and the same hereby is dismissed without prejudice as to all defendants and final judgment, be and the same hereby is entered in their favor; and the Clerk of this Court shall give prompt notice hereof by mailing copies of this Order and the Court's Opinion to the Clerk, Judicial Panel on Multidistrict Litigation, and to the Clerks of each of the transferor District Courts herein.

Dated: July 5, 1972

RAYMOND J. PETTINE
Raymond J. Pettine
Chief Judge
United States District Court
for the District of Rhode Island

UNITED STATES COURT OF APPEALS

FOR THE FIRST CIRCUIT

No. 72-1288

IN RE KAUFFMAN MUTUAL FUND ACTIONS

JOSEPH B. KAUFFMAN,

Plaintiff-Appellant.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

Before COFFIN, *Chief Judge.*
ALDRICH and MCENTEE, *Circuit Judges.*

May 14, 1973

ALDRICH, *Senior Circuit Judge.* This appeal challenges two rulings of the district court that plaintiff's derivative suit on behalf of certain mutual funds of which he is a

shareholder is not maintainable because of failure to allege sufficient reason to excuse a prior demand on the directors, and, as to two funds, on the shareholders. F. R. Civ. P. Rule 23.1, post.[1] We reach only the first issue.

Plaintiff is a shareholder in four mutual funds, the Dreyfus Fund, Inc., Manhattan Fund, Inc., Fidelity Trend Fund, Inc., and the Putnam Growth Fund, the latter two being, respectively, a Massachusetts corporation and a Massachusetts business trust. In December, 1968 he filed this suit in the District of New Jersey in several capacities —not only as a shareholder of the above funds, but also, *inter alia*, as a representative of shareholders of other funds—alleging antitrust and Investment Company Act causes of action against many large mutual funds, their external investment advisers, directors affiliated with both funds and advisers, and the Investment Company Institute, the trade association for the mutual fund industry. The thrust of the antitrust claim, the only one relevant to this proceeding, is that defendant fund directors, who were also affiliated with investment advisers, conspired with funds, advisers, and others to set excessive noncompetitive management fee schedules based solely on the average net assets of the funds. In April, 1969 defense counsel submitted a list of fifteen preliminary motions, divided into three groups, the second group including a Rule 23.1 attack on plaintiff's failure to make a demand on directors and shareholders. The district court dealt with the first group, challenging plaintiff's capacity to sue, denied the motions, *Kauffman v. Dreyfus Fund, Inc.*, D. N. J., 1969, 51 F. R. D. 18, but certified an inter-

1. While we decided the merits in *Moses v. Burgin*, 1 Cir., 1971, 445 F. 2d 369, *cert. denied sub nom. Johnson v. Moses*, 404 U. S. 994, a suit involving a mutual fund, where no demand had been made, this issue was not there raised and we do not agree with plaintiff that our action was a sub silentio ruling on that issue.

locutory appeal. The Third Circuit held that plaintiff could only sue derivatively on behalf of the four funds in which he owned shares [the "Kauffman funds"]. 434 F. 2d 727, *cert. denied* 401 U. S. 974.

Thereafter, when a second group of motions attacking jurisdiction, venue, and process, but not then including the Rule 23.1 motion, was pressed, the district court severed the antitrust claim (Count I) from the others, and divided it into ten separate actions to be tried in ten separate districts. In July, 1971 plaintiff applied for consolidation under 28 U. S. C. § 1407(a) and in January, 1972 the Judicial Panel on Multidistrict Litigation transferred some of the actions for consolidated pretrial proceedings to the District of Massachusetts. *In re Kauffman Mutual Fund Actions*, J. P. M. L. 1972, 337 F. Supp. 1337. After an informal pretrial conference the district court issued a pretrial order to govern future proceedings, setting a time schedule for disposing of motions and looking toward the establishment of a timetable for completing "first-wave" and "second-wave" discovery. Defendants then brought forward, (1) a Rule 23.1 motion to dismiss for failure of plaintiff to make a demand on directors of the Kauffman funds, (2) a Rule 23.1 motion to dismiss, on behalf of the two Massachusetts Kauffman funds, for failure of plaintiff to make a demand on stockholders; (3) a Rule 23.1 motion to dismiss because of plaintiff's inability to give fair representation, and (4) a motion by non-Kauffman funds to dismiss for failure to state or waiver of any claim upon which relief could be granted. The court, though denying the latter two motions, granted the first two and dismissed the complaint on July 7, 1972. This appeal followed; there being no cross-appeal.

Relative to the reasons for not making demand upon the directors, the complaint, the pertinent parts of which

are summarized in the margin,[2] alleges the following: (1) a demand would have been futile; (2) the unlawful combination and conspiracy began at least as early as

---

2.

10. [Demand would have been futile.]

22. [At all times directors of each fund have been affiliated with their investment advisers.]

23. [At all times (a) the affiliated directors and their investment advisers] "have dominated and controlled their respective . . . funds and their personnel, policies and boards of directors." (b) [the affiliated directors] "have dominated and controlled their respective investment advisers and their personnel, policies and boards of directors."

24. [At all times the contracts and fee agreements between the investment advisers and the funds] "have not been either the subject or the result of arm's-length bargaining between them."

25. [The management fees are] "calculated solely on the basis of . . . average net assets."

27. [. . . and are improperly measured and grossly excessive.]

28. "The combination and conspiracy involved in this action consisted and consist of a continuing agreement, understanding and concert of action, *inter alia*, between and among:

(a) each externally managed mutual fund and its respective investment adviser;

(b) each externally managed mutual fund and its self-dealing directors;

(c) each self-dealing director and his respective investment adviser;

(k) the members of the externally managed mutual funds, investment advisers, and self-dealing directors classes and the Institute.

29. "The substantial terms of the aforesaid combination and conspiracy were and are to:

(a) fix and adopt similar schedules of grossly excessive management fees unrelated to the services performed by investment advisers and the performance of the externally managed mutual funds;

(b) maintain and stabilize prices for the services performed by investment advisers by adherence to said similar schedules of management fees;

(c) refrain from competing for the business of externally managed mutual funds or the business of investment advisers.

30. "All of the defendants . . . have acquiesced, encouraged, cooperated and assisted in the effectuation and maintenance of the aforesaid combination and conspiracy."

January 1, 1965; (3) the fund directors who were affiliated with the external advisers dominated and controlled the personnel, policies, and boards of directors of the funds; (4) the contracts between the advisers and the funds "have not been either the subject or the result of arm's length bargaining"; (5) the fee for investment advisory and management services, being based solely on the average net assets of a fund, bore no relation to services performed or results and were grossly excessive; (6) the conspiracy involved the funds, their advisers, the "self-dealing" directors, the Investment Company Institute and others unknown, and was aimed at fixing and maintaining the grossly excessive management fees and refraining from competition; and (7) all of the defendants "acquiesced, encouraged, cooperated and assisted in the effectuation and maintenance" of the conspiracy. By uncontradicted affidavits submitted in the spring of 1972, it was established that a majority of the directors of each of the Kauffman funds were not "affiliated" directors within the meaning of section 2(a)(3) of the Investment Company Act of 1940, 15 U. S. C. § 80a-2(a)(3).[3] On the basis of these allegations and affidavits, the district court held that plaintiff had "not sufficiently shown the merits of his allegations of futility," noting the presumption in 15 U. S. C. § 80a-2(a)(9) that a natural person shall be presumed not to be controlled, and that it could not assume that the non-affiliated (majority) directors had been lax in their duties or that appeal to them

3. The affidavits spoke in terms of "affiliated" persons, since the Act at the time of suit required that at least 40% of a fund's directors not be "affiliated" with the fund's adviser. In 1970 the Act was amended to require that at least 40% of the directors not be "interested" persons, as defined in 15 U. S. C. § 80a-2(a)(19), a somewhat broader category.

The affidavits showed that five of nine trustees of the Putnam Growth Fund, five of the seven directors of Dreyfus, five of the eight directors of Fidelity, and three of the five directors of Manhattan were unaffiliated within the meaning of the Act. They reveal nothing more, except brief vocational information.

would be futile. While the court's reference at this stage to a presumption may have been erroneous,[4] we agree with the court's result.

For lawyers and judges accustomed to the liberalized "notice" pleading of the Federal Rules, F. R. Civ. P. 8, a brief review of the background of Rule 23.1 is in order. Rule 23.1 is not an ordinary, but an exceptional rule of pleading, serving a special purpose, and requiring a different judicial approach. Socially desirable as minority stockholders' actions may be thought to be, *see* Emerson and Latchman, Shareholder Democracy ch. VIII (1954); *Pomerantz v. Clark*, D. Mass., 1951, 101 F. Supp. 341, 346, it is normally the directors, not the stockholders, who conduct the affairs of the company. Hence, to be allowed, sua sponte, to place himself in charge without first affording the directors the opportunity to occupy their normal status, a stockholder must show that his case is exceptional. His initial burden is to demonstrate why the directors are incapable of doing their duty, or as the Court has put it, to show that "the antagonism between the directory and the corporate interest . . . be unmistakable." *Delaware & Hudson Co. v. Albany & Susquehanna R. R.*, 1909, 213 U. S. 435, 447. This has long meant, as the Court stated in *Hawes v. Oakland*, 1881, 104 U. S. 450, cited in *Delaware*, that the "cause of failure [to induce corporate action] . . . should be stated with particularity." 104 U. S. at 461. *See also Wathen v. Jackson Oil & Refining Co.*, 1915, 235 U. S. 635, 639-40.

Rule 23.1—"The complaint shall also allege with particularity . . . the reasons for . . . not making the [de-

4. Although certain facts were presented by affidavit, n. 3, ante, basically the motion to dismiss tested the sufficiency, *vel non*, of the complaint. The presumption supplied by 15 U. S. C. § 80a-2(a)(9) that "[a] natural person shall be presumed not to be a controlled person," whatever may be its effect at a trial, could not be used to contradict the complaint, if plaintiff is correct that the court so employed it.

mand]"—is thus the embodiment of a long-standing principle, or, as the Massachusetts court said in a parallel case, *Bartlett v. New York, N. H. & H. R. R.*, 1915, 221 Mass. 530, at 538, "It is not a technical rule of pleading, but one of substantive right." Whether the word "substantive" is exact, it is clear that the "particularity" must appear in the pleading itself; the stockholder may not plead in general terms, hoping that, by discovery or otherwise, he can later establish a case. Indeed, if the requirement could be met otherwise, it would be meaningless.

Returning to our listing of plaintiff's allegations, ante, we find that, (1) (demand would be futile) is merely a conclusion, not a reason; (2) (dates) does not purport to state a reason; (3) (domination and control) is, again, a statement of ultimate fact, not meeting the test of "particularity"; (4) and (5) are why, allegedly, the acts are wrongful; (6) advances nothing over (3), (4) and (5); (7) (all the named defendants conspired) insofar as it names individual director-defendants who are financially interested in the attacked transaction, fails to go far enough. We will group and discuss these allegations, to the extent that they purport to be reasons for not making a demand, somewhat differently.

1. *An allegation of domination and control, unsupported by underlying facts, does not satisfy the requirement of particularity.*

The complaint asserts that the directors affiliated with the management advisers "dominate and control" the directorates of the funds. It is conceded, however, that in each instance the self-interested, affiliated director-defendants constitute less than a majority of the membership of the board. Were there a majority, this is a particularity from which a conclusion of control might follow. *Delaware*, ante, at 443; *Rogers v. American Can Co.*, 3 Cir., 1962, 305

F. 2d 297, 299. Without it, or some other factual support, *see, e.g., Cathedral Estates v. Taft Realty Corp.*, 2 Cir., 1955, 228 F. 2d 85, (stock control of plaintiff's corporation by interested defendants), conclusory pleading is not enough. *See Lucking v. Delano*, 6 Cir., 1941, 117 F. 2d 159, 160; *Robison v. Caster*, 7 Cir., 1966, 356 F. 2d 924, 926-27; *Dunphy v. Traveller Newspaper Assoc.*, 1888, 146 Mass. 495, 498; *Bartlett v. New York, N. H. & H. R. R.*, ante, at 534-35. Plaintiff must allege specific facts demonstrating the unmistakable link between the unaffiliated majority and the affiliated and allegedly wrongdoing minority. *Cf. Baffino v. Bradford*, 1972, D. Minn., 57 F. R. D. 79.

In this circumstance plaintiff's brief seeks to infer collective hostility to his claims by dwelling on the fact that his suit has met extended resistance. Whatever might be the effect if the resistance were on substantive grounds, *cf. DePinto v. Provident Security Life Ins. Co.*, 9 Cir., 1963, 323 F. 2d 826, *cert. denied* 376 U. S. 950, to attempt to capitalize on the circumstance that the corporations are seeking to dismiss because of plaintiff's failure to make demand is classic bootstrap. Domination is not established by insistence on the right to have plaintiff plead a valid basis for suit.

2. *The fact that the named defendants participated is not enough to excuse demand upon the directorate.*

Apart from "control," only the affiliated directors—a minority of each board—are alleged to have "acquiesced, encouraged, cooperated and assisted in the effectuation and maintenance" of the conspiracy. The unaffiliated directors are not named as defendants, or even as the ones who approved the acts complained of. *Bartlett v. New York, N. H. & H. R. R.*, ante, at 536-37. If we were to rely on plaintiff's citation of *Moses v. Burgin*, n. 1., ante, for anything, it would be for the fact that unaffiliated directors do not neces-

sarily know all that is going on, pointing up again Rule 23.1's requirement of particularity of allegation. The complaint alleges that the "funds" participated in the conspiracy, but does not specify in what manner. What is basically important, the complaint does not allege that those who were unaffiliated directors at the time of suit participated; viz., that the unaffiliated directors who would have voted on plaintiff's demand in 1968, had he made one, were the same ones (and hence, assertedly, impervious to a demand) that composed the boards when the contracts in question were approved.

There is no burden on the court to make such assumptions. Were we, in disregard of the rule, to add to the complaint, we could only wonder whether we were not making interpolations that plaintiff could not in good faith sustain. Plaintiff's explanation made in argument why he sued only the affiliated directors, whatever its value, cannot meet his burden of showing that as to the majority of the board at the time of suit demand would have been futile. Even were we mistaken with respect to our next point, on which, essentially, he grounds his claim of particularity, there are thus no sufficient allegations of futility relating to a majority of the board.

3. *Approval by the directors of action alleged to be injurious to the corporation is not sufficient to excuse demand, except in circumstances not here alleged.*

There is a further reason that, in the light of the extensive argumentation that has been made to us, we feel we should deal with. Even if we could assume that there had never been a change in the complement of the boards of directors, and that those who were the directors at the time of the suit had approved of the transactions presently attacked, it would not follow that mere prior participation would excuse making the demand. Where mere approval

of the corporate action, absent self-interest or other indication of bias, is the sole basis for establishing the directors' "wrongdoing" and hence for excusing demand on them, plaintiff's suit should ordinarily be dismissed. In fact, only a single court, see ¶2 of n. 6, post, has held otherwise.

In this respect, the nature of the alleged misconduct must be considered. Logic suggests a sharp distinction between a transaction completely undirected to a corporate purpose and one which, while perhaps vulnerable to criticism, is of a character that could be thought to serve the interests of the company. If the transaction attacked was one solely for the benefit of minority, interested directors —taking out a sham loan, trading in worthless real estate— the approval of the other, nominally disinterested, directors is prima facie inexplicable. If a director goes along with a colleague in an act on its face advantageous only to that colleague and not to the corporation, this in itself is a circumstance, or particularity, supporting the claim that he is under that colleague's control. It may be assumed that he would remain so when the directorate votes on plaintiff's demand. *See Meltzer v. Atlantic Research Corp.*, 4 Cir., 1964, 330 F. 2d 946, *cert. denied sub nom. Sloan v. Meltzer*, 379 U. S. 841. It does not follow, however, that a director who merely made an erroneous business judgment in connection with what was plainly a corporate act will "refuse to do [his] duty in behalf of the corporation if [he] were asked to do so." *Bartlett v. New York, N. H. & H. R. R.*, ante at 536. Indeed, to excuse demand in these circumstances—majority of the board approval of an allegedly injurious corporate act—would lead to serious dilution of Rule 23.1.

A minority stockholder, unless his claim is worthless on its face, necessarily alleges some illegal transaction or conduct harmful to the corporation. If demand is to be excused

merely because the directors participated, the same could be said with respect to those who had failed to oppose, or, indeed, who, as new directors, had merely neglected to take action against their predecessors. If by plaintiff's merely alleging error, the directors are to be presumed incapable of exercising sound business judgment, Rule 23.1 would become virtually meaningless—a stockholder would be entitled to try the case on the merits, (viz., to establish that the fees were excessive, or improperly arrived at, or in violation of the antitrust laws) to show that he had a right to bring it.[5]

The conduct alleged in the present case was not, vis-a-vis the individual funds, undirected to a legitimate corporate purpose. The selection of an adviser, and a decision to compensate him, is obvious corporate business for a mutual fund. There is no facial impropriety in determining payment by a formula. A court sitting in Boston can take judicial notice that testamentary and indenture trustees are commonly compensated on a formula basis. Selection of a particular formula, of course, may be improper, and the underlying business judgment may be sufficiently unsound to call for correction. But it does not follow that it is to be conclusively presumed in such a case that an unaffiliated, or disinterested director, if demand were made upon him, would be unable to exercise an independent judgment in

5. We do not accept as contrary the case of *Smith v. Sperling*, 1957, 354 U. S. 91. The sole question there raised, commencing with a 30-page opinion of the district court, 177 F. Supp. 781, was whether the corporation, as an indispensable party, was to be realigned as party plaintiff for jurisdictional purposes when it was found by the district court, after taking testimony, not to be antagonistic to plaintiff's claim. It is true that the Supreme Court, in discussing plaintiff's failure to make a demand, relied on the allegation that all of the directors had approved the contracts complained of. However, it made no reference to the nature of the contracts, nor to the interest *vel non* of the directors. In addition, it noted that other reasons were asserted for failure to make demand.

considering what new course to take.[6] *See Ash v. International Business Machines, Inc.*, 3 Cir., 1965, 353 F. 2d 491, *cert. denied* 384 U. S. 927.

Nor do we think that an exception is to be made in the case of unaffiliated directors of a mutual fund on the ground that since they are expected to be sensitive to misconduct of this variety they are automatically incapacitated from performing their duties—their approval or acquiescence making them "wrongdoers"—once a stockholder alleges a corporate injury stemming from the adviser-fund relationship. Apart from the fact that this, again, would enable a plaintiff to try his case on the merits in order to determine whether he had a right to bring it, it would be a misconception of the nature of unaffiliated directors. Normally self-dealing by any corporate directors is suspect. Con-

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6. Plaintiff, following argument, has cited *Jannes v. Microwave Communications, Inc.*, N. D. Ill., 1972, 57 F. R. D. 18, a Rule 10b-5 misrepresentation case (15 U. S. C. § 78j(b)). We do not find it helpful. In the first place the court, in finding the derivative complaint sufficient, said it applied "the usual standard of whether any set of facts can be shown which would prove futility," 57 F. R. D. at 21, citing a Fifth Circuit decision which, in turn, purported to rely, as does the present plaintiff elsewhere, on *Conley v. Gibson*, 1957, 355 U. S. 41. *Conley*, which dealt only with F. R. Civ. P. 8 "notice pleading," is no authority for such an interpretation for Rule 23.1. More important, the *Jannes* court said that even a strict standard showed "self interest" on the part of all the directors.

We cannot similarly distinguish the recent case of *Papilsky v. Berndt*, S. D. N. Y., 3/19/73, CCH Fed. Sec. L. R. ¶ 93,902. We do, however, note that the authorities cited do not, in fact, support the decision. Thus in *Cathedral Estates v. Taft Realty Corp.*, 2 Cir., 1955, 228 F. 2d 85, the corporate conveyance was by a majority of the directors to a corporation completely controlled by them. In *Dopp v. American Electronic Laboratories, Inc.*, S. D. N. Y., 1972, 55 F. R. D. 151, the complaint contained specific allegations beyond the conclusion that the directors had approved the transaction. And as to the case which the court regarded as most directly in point, *Liboff v. Wolfson*, 5 Cir., 1971, 437 F. 2d 121, in addition to the fact that we believe the Fifth Circuit confuses Rule 23.1 with notice pleading, the court specifically noted, at p. 122, that the "defendants-appellees conceded on oral argument that . . . a majority of the board . . . [met the description of 'ownership and control'] as to them."

gress recognized, however, that a certain type of self-dealing is endemic in a mutual fund, and must be permitted. In order to make sure that the directorate not be top-heavy, it provided for a minmum number of directors who would not be so interested. We do not believe it should follow from this that, as directors required to be disinterested in a particular transaction, they differ in their fiduciary obligations from disinterested directors in any other corporate venture. All disinterested directors must "act honestly and according to their best judgment for the interests of all." *Corbus v. Alaska Treadwell Gold Mining Co.*, 1903, 187 U. S. 455, 463. When corporate action, or inaction, is subsequently challenged, their duty is not extinguished, but, rather, refocused. After a demand provides them with "full knowledge of the basis of the claim," *Halprin v. Babbitt*, 1 Cir., 1962, 303 F. 2d 138, 141, it is for the directors, who have "the advantage of familiarity with the enterprise, with those who have conducted it and with the record of success or failure" to decide on the appropriate corporate response. *Pomerantz v. Clark*, ante at 344. To the extent that they are "watchdogs" they should be given the opportunity, not deprived of it.

We recognize the social desirability of bona fide, well founded minority suits. We also recognize the tremendous waste involved in suits that are not well founded. We do not accept the dictum in *deHaas v. Empire Petroleum Co.*, 10 Cir., 1970, 435 F. 2d 1223, at 1228, that "[c]ourts have generally been lenient in excusing demand" if it is to be applied to allegations as substantively deficient as the present. Such easy remarks overlook the requirement that the directors' "antagonism . . . be unmistakable." *Delaware & Hudson Co. v. Albany R. R.*, ante. If, as plaintiff suggests, this frustrates his ability to prosecute a worthwhile suit, the answer is that he was not entitled to bring it.

No further question need be reached. In affirming we must, however, comment upon one phrase in the order of the district court granting the motion to dismiss, that it is "without prejudice." This must mean without prejudice as to the substantive cause of action. The dismissal is with prejudice on the issue of the obligation to make a demand on the directors with respect to that substantive complaint. The principle applies that "[a]lthough, where a judgment for the defendant is not on the merits, the plaintiff is not precluded from maintaining a new action on the same cause of action, he is precluded from relitigating the very question which was litigated in the prior action." Restatement of Judgments § 49, comment b, at 195 (1942). *See Acree v. Air Line Pilots Assoc.*, 5 Cir., 1968, 390 F. 2d 199, 203, *cert. denied* 393 U. S. 852; *Estevez v. Nabers*, 5 Cir., 1955, 219 F. 2d 321, 324; IB Moore's Federal Practice ¶ .405[5]. *Cf. Stoll v. Gottlieb*, 1938, 305 U. S. 165, 171-72; *Stuhl v. Tauro*, 1 Cir., 1973, F. 2d .

Affirmed.

COFFIN, *Chief Judge* (concurring). I concur in the judgment of affirmance. While agreeing that unsupported allegations of domination of a majority by a minority are insufficient, I would, but for one defect, find such support in the allegations that the named defendants, which include the mutual funds (and necessarily their boards of directors), "acquiesced, encouraged, cooperated and assisted in the effectuation and maintenance" of the conspiracy to establish exorbitant basic fee agreements benefiting fund advisers (and thus affiliated directors) to the detriment of the funds and in violation of the antitrust laws. But I view as fatal the absence of an allegation or indication in the affidavits, to use the court's phrasing, "that the unaffiliated directors who would have voted on plaintiff's demand in 1968, had he made one, were the same ones (and hence,

assertedly, impervious to a demand) that composed the boards when the contracts in question were approved." We cannot assume that new unaffiliated directors would be unwilling to reconsider the wisdom or legality of their predecessors' actions and, if appropriate, bring suit.

I would, however, not go so far as the court does in delineating "the sharp distinction", for purposes of excusing demand under Rule 23.1, between actions which "could be thought to serve the interests of the company" and those of a fraudulent or self-dealing nature. The distinction has not been so articulated in almost a century of derivative suit jurisprudence, although concededly most of the prominent cases have involved just such factual situations. Yet the language of a number of cases traces a wider compass.* Moreover, these are times when corporations are exceeding in size and impact even the giantism of the past, when new layers and dimensions of corporate obligation are being recognized, and when the importance of directorate oversight of the management technocracy is

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* *Delaware & Hudson Co. v. Albany & Susquehanna R. R.*, 213 U. S. 435, 451 (1909) ("good faith . . . need not be questioned"); *United Copper Securities Co. v. Amalgamated Copper Co.*, 244 U. S. 261, 264 (1917) ("no allegation that . . . directors . . . have been guilty of any misconduct whatsoever"); *Smith v. Sperling*, 354 U. S. 91, 95 (1957) ("There is antagonism whenever the management is aligned against the stockholder and defends a course of conduct which he attacks. The charge normally is cast in terms of fraud, breach of trust, or illegality"); *Cathedral Estates v. Taft Realty Corp.*, 228 F. 2d 85, 88 (2d Cir. 1955) ("where the directors . . . are . . . involved in the transaction attacked, a demand on them is presumptively futile and need not be made"); *Ash v. International Business Machines, Inc.*, 353 F. 2d 491, 493 (3d Cir. 1965) ("the stockholder shall allege . . . that the directors of the corporation are personally involved . . . in the alleged wrongdoing in a way calculated to impair their exercise of business judgment on behalf of the corporation"); *Liboff v. Wolfson*, 437 F. 2d 121, 122 (5th Cir. 1971) (the complaint, held to "fully meet the requirements of the rule", alleged "The majority of said directors, participated, approved of and acquiesced in said transaction"); *Papilsky v. Berndt*, CCH Fed. Sec. L. R. 93,615, 93,616 (S. D. N. Y. Mar. 19, 1973) (allegation that "the directors participated or acquiesced in the wrongs alleged" held sufficient).

greater than ever. A higher degree of professionalism, sensitivity, and scrutiny may fairly be expected on the part of directors today than in a simpler era. I am therefore reluctant, by resort to formula, to set boundaries to the action or inaction of directors, beyond which demand on them shall always be required.

Even if, however, such boundaries can be justified for corporate directors in general, on the supposition that they can reverse gears on a course previously undertaken once attention is refocused by an allegation that it constitutes a wrong to the corporation, the broad extension of "first refusals" to unaffiliated or independent directors of mutual funds would seem singularly inappropriate. For I believe, unlike the court, that the unaffiliated directors of mutual funds have a higher obligation of inquiry than directors of ordinary corporations, at least as to the type of transaction under assault here. As we said in *Moses v. Burgin*, 445 F. 2d 369, 376 (1st Cir. 1971), Congress intended that these board members act as "independent watchdog directors". The primary object of their surveillance is, patently, transactions between the funds and the investment advisers in which the other directors are personally interested. Their raison d'etre is acute scrutiny of the very contracts here attacked.

These contracts, additionally, are major corporate actions from any perspective. It thus seems reasonable to assume that the directors would be given advance notice of at least their final content and of the meeting at which they would be considered. Whatever the significance for excusing demand of mere knowing acquisecence in impending major corporate actions in other settings, *see Liboff, supra*, I believe that such passive acceptance by unaffiliated directors of the very transactions which justify their place on the directorate would be sufficient involvement or subservience to find them unlikely to respond meaningfully to a

demand. Here, there are no allegations regarding the meetings and the actual votes on the challenged fees or the relevant corporate quorum rules. But whether one assumes that action by a majority of the total membership or merely a majority of those actually present is required, clearly some unaffiliated directors either voted for the contracts or failed to vote, in person or by proxy, or appear at the appropriate meeting. Under my view, this would be enough to excuse demand, had it been alleged that the unaffiliated membership was the same at both contract-making and demand time.

I also note that the management fee contracts are not attacked as simply ultra vires or as the product of mere negligence or even of "unsound" or "erroneous business judgment". They are alleged to be illegal under federal antitrust laws. If I were to calibrate a scale to measure the impact of varying improprieties. I would rate such an allegation fairy high. I find it hard to imagine that a director, however unaffiliated, who had participated, or under these circumstances knowingly acquiesced, in a major transaction, albeit for a corporate purpose, would authorize a suit, effectively against himself, claiming that the transaction violated the federal antitrust laws. Even independent watchdogs cannot be thought ready to sign a confession of that magnitude.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT.

No. 72-1288.

IN RE
KAUFFMAN MUTUAL FUND ACTIONS

JOSEPH B. KAUFFMAN,
Plaintiff-Appellant.

JUDGMENT.

Entered May 14, 1973.

This cause came on to be heard on appeal from the United States District Court for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The order of the District Court is affirmed.

BY THE COURT:

/s/ DANA H. GALLUP,
Clerk.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT.

No. 72-1288.

IN RE
KAUFFMAN MUTUAL FUND ACTIONS

JOSEPH B. KAUFFMAN,
Plaintiff-Appellant.

ORDER OF COURT.

Entered May 29, 1973.

The Clerk is directed to file for identification purposes only, the affidavit of David H. Pittinsky, tendered with the petition for rehearing.

BY THE COURT:

/s/ DANA H. GALLUP,
Clerk.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT.

No. 72-1288.

IN RE
KAUFFMAN MUTUAL FUND ACTIONS

JOSEPH B. KAUFFMAN,
Plaintiff-Appellant.

Before COFFIN, *Chief Judge*,
ALDRICH and MCENTEE, *Circuit Judges*.

MEMORANDUM AND ORDER ON PETITION FOR REHEARING.

Entered June 4, 1973.

ALDRICH, *Senior Judge*.

Plaintiff has filed a petition for rehearing. Insofar as it repeats points already articulated by the minority opinion, while avoiding discussion of the reasons given by the court, it is superfluous. It should be manifest that the court does not reach internal disagreements lightly.

Certain other contentions call for comment. We do not agree that the complaint's allegation of a continuing wrong can substitute for one detailing the length of individual service, and, hence, the opportunity for consideration by the unaffiliated directors. It is only necessary to

read the finespun argument plaintiff presently attempts against his obligation to plead with particularity to see that plaintiff has not met the problems in his complaint that we pointed out in section two of the opinion. For clarity and simplicity of allegation in this area, *see Papilsky v. Berndt*, cited in n.6 thereof. *Cf. Bartlett v. New York, N. H. & H. R. R.*, 1915, 221 Mass. 530, 537.

Alternatively, plaintiff has delivered to the clerk, and speaks of as "filed," an affidavit by which he would show that in fact the various directorates remained constant for several years prior to commencement of his action. Plaintiff cannot file documents enlarging the record without leave of court. We do not grant leave. Nor are we moved at this time to permit an amendment to the complaint. Surely plaintiff must have realized his obligation to show an excuse extending to the majority of the Board. *Cathedral Estates v. Taft Realty Corp.*, 2 Cir., 1955, 228 F. 2d 85. Defendants' brief abundantly pointed out that the unaffiliated directors constituted the majority of each board, and there was ample time for plaintiff to make its now proffered assertion. This is particularly so as to a plaintiff who complains that the case has been vigorously defended for four years.[1] In addition, it seems unnecessary to note, the amendment would not overcome the hurdle posed by section three of the court's opinion.

Next, plaintiff asserts, inferentially, that we erred in distinguishing DePinto v. Provident Security Life Ins. Co. on the ground that defendants here did not defend on the merits. We observe, (1) any argument in this respect

1. Plaintiff's citation of a case in which we recognized there would be a right to amend on a quite different set of facts does not mean that the right exists at all stages of a case or regardless of the type of pleading deficiency. Nor does *Foman v. Davis*, 1962, 371 U. S. 178, where the Court corrected our over-strict reading of F. R. Civ. P. 15(a).

should have been made earlier, *cf.* Local Rule 15, particularly when we did no more than accept an argument fully articulated in defendants' brief; (2) plaintiff's present claim is based upon pleading allegedly filed by one of the four funds,[2] which is not in the record before us, and (3) we do not consider that the mere filing, along with a motion to dismiss, as permitted by the rules, of pleading addressed to the merits, effects a waiver of the failure to make a demand raised by the motion. In plaintiff's case of *DePinto*, if in fact correctly decided, the action was tried on the merits.

Finally, passing plaintiff's repeated, but unjustified, claim that we have made a decision on the merits, we observe that it is late in the day for plaintiff, appealing from a dismissal for a failure to make demand, to discover that the proper order that we should now make is not to dismiss, but to retain jurisdiction pending a demand. For this he cites *Laveson v. Trans World Airlines*, 3 Cir., 1972, 471 F. 2d 76, a primary jurisdiction case involving quite different principles. Never having made this claim before, plaintiff strains our credulity by saying he "was previously unaware that the Court would . . . dismiss outright the complaint, rather than stay the action." While we express no view as to the success of a new action after demand is made, we deny the request to keep this action alive, in part because it raises a substantial question too late.

The Petition for rehearing is denied.

BY THE COURT:

/s/ DANA H. GALLUP,
Clerk.

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2. The argument that all four funds sought to defend on the merits because they moved to dismiss for failure to state a claim is specious.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT.

No. 72-1288.

IN RE
KAUFFMAN MUTUAL FUND ACTIONS

JOSEPH B. KAUFFMAN,
Plaintiff-Appellant.

ORDER OF COURT.

Entered June 8, 1973.

Upon motion of appellant

It is ordered that mandate be, and the same hereby is, stayed pending the filing and disposition of a petition for writ of certiorari in the Supreme Court of the United States, the same to be filed by July 11, 1973, and notice of such filing to be filed promptly with the Clerk of this Court.

BY THE COURT:

/s/ DANA H. GALLUP,
Clerk.

COMPLAINT.

Count One.

1. This action is instituted under Section 16 of the Act of Congress of October 15, 1914, c. 323, 38 Stat. 737 (15 USC § 26) for equitable relief and under Section 4 of the Act of Congress of October 15, 1914, c. 323, 38 Stat. 731 (15 USC § 15) to recover treble damages and the costs of suit, including reasonable attorneys' fees, against the defendants for the injuries sustained by plaintiff and members of the class, represented by him and, derivatively, by defendant externally managed mutual funds and members of the class represented by them by reason of defendants' violations as hereinafter alleged of Sections 1 and 2 of the Act of Congress of July 2, 1890, c. 647, 26 Stat. 209 (15 USC §§ 1 and 2), commonly known as the Sherman Act.

A. *Plaintiff and Plaintiff Classes.*

2. Plaintiff Joseph B. Kauffman ("Kauffman") is an individual with his residence at 27 South Oakland Avenue, Ventnor City, New Jersey. Kauffman has been a shareholder of the following externally managed, open-end investment companies ("externally managed mutual funds"): defendant Fidelity Trend Fund, Inc. since November 23, 1965; defendant The Putnam Growth Fund since November 23, 1965; defendant The Dreyfus Fund Inc. since November 24, 1965; and defendant Manhattan Fund, Inc. since February 24, 1966. At present, Kauffman owns 413 shares of Fidelity Trend Fund, Inc. common stock, 476 shares of The Putnam Growth Fund common stock, 826 shares of The Dreyfus Fund Inc. common stock and 51 shares of Manhattan Fund, Inc., common stock.

3. Plaintiff is representative of a class as defined by Rule 23 of the Federal Rules of Civil Procedure and brings this action on behalf of himself and the entire class.

4. Plaintiff also brings this action derivatively on behalf of defendant externally managed mutual funds and, in his capacity as representative, derivatively on behalf of all other externally managed mutual funds affiliated therewith or related thereto.

5. (a) The representative class consists of all shareholders of the common stock of defendant externally managed mutual funds and all other shareholders of externally managed mutual funds affiliated therewith or related thereto.

(b) The derivative class consists of defendant externally managed mutual funds and all other externally managed mutual funds affiliated therewith or related thereto.

6. Each class is so numerous and geographically so widely distributed that joinder of all members is impracticable. There are questions of law and fact common to each class. The claims of the representative and derivative plaintiff are typical of the claims of each class and plaintiff will fairly and adequately protect the interests of each class.

7. The prosecution of separate actions by individual members of each class would create the risk of:

(a) inconsistent or varying adjudications in different jurisdictions with respect to individual members of each class which would establish incompatible standards of conduct for the parties opposing each class; and

(b) adjudications with respect to individual members of each class which would as a practical matter

be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests.

8. The questions of law and fact common to the members of each class predominate over any questions affecting only individual members and each class action is superior to other available methods for the fair and efficient adjudication of the controversy.

9. The derivative action is not a collusive one to confer jurisdiction on a Court of the United States which it would not have otherwise.

10. Demand by plaintiff that defendant externally managed mutual funds or any other externally managed mutual funds affiliated therewith or related thereto bring this action would have been futile and, therefore, was not made.

B. *Defendants and Defendant Classes.*

11. (a) The following defendants are externally managed mutual funds (corporations unless otherwise indicated), each of which is sued individually, as a co-conspirator, as a member of defendant Investment Company Institute, as an externally managed mutual fund and as a representative on behalf of all other externally managed mutual funds affiliated therewith or related thereto with their principal places of business, as indicated:

[65 Mutual Fund Defendants Listed]

(b) The following defendants are investment advisers of defendant externally managed mutual funds ("investment advisers") (corporations unless otherwise indicated), each of which is sued individually, as a co-conspirator, as an investment adviser and as a representative on behalf of all other investment advisers affiliated therewith or re-

lated thereto, with their principal places of business, as indicated:

[38 Investment Adviser Defendants Listed]

(c) The following defendants are directors or trustees of defendant externally managed mutual funds and directors or partners of defendant investment advisers ("self-dealing directors"), each of whom is sued individually, as a co-conspirator, as a self-dealing director and as a representative of all other self-dealing directors similarly situated. Set forth below the names of the self-dealing directors are defendant externally managed mutual funds and defendant investment advisers with which they are affiliated.

[37 Affiliated Director Defendants Listed]

(d) Defendant Investment Company Institute ("Institute") is an unincorporated association with its principal place of business at 61 Broadway, New York, New York. It is sued individually, as a co-conspirator; and as the trade association representative for defendant externally managed mutual funds and defendant investment advisers.

12. Each of the representative defendants [¶¶ 12(a), (b) and (c) *supra*] is representative of a class as defined by Rule 23 of the Federal Rules of Civil Procedure and this action is brought against each of them and each entire class of which they are representative.

13. (a) The externally managed mutual funds class consists of the defendant externally managed mutual funds and all other externally managed mutual funds affiliated therewith or related thereto.

(b) The investment advisers class consists of the defendant investment advisers and all other investment advisers affiliated therewith or related thereto.

(c) The self-dealing directors class consists of:

(i) the self-dealing directors;

(ii) all other individuals who contemporaneously are directors or trustees of the defendant externally managed mutual funds and directors or partners of defendant investment advisers; and

(iii) all other individuals who contemporaneously are directors or trustees of externally managed mutual funds affiliated with or related to defendant externally managed mutual funds and directors or partners of investment advisers affiliated with or related to defendant investment advisers.

14. Each class is so numerous and geographically so widely distributed that joinder of all members is impracticable. There are questions of law and fact common to each class. The defenses of each class of representative defendants will be typical of the defenses of each class and each class of representative defendants will fairly and adequately protect the interests of that class.

15. The prosecution of separate actions against individual members of each class would create the risk of:

(a) inconsistent or varying adjudications in different jurisdictions with respect to individual members of each class; and

(b) adjudications with respect to individual members of each class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests.

16. The defendants and each of their respective classes have acted or refused to act on grounds generally

applicable to plaintiff and the members of his class and, derivatively, to defendant externally managed mutual funds and the members of their class, thereby making appropriate final injunctive relief against defendants and each of their respective classes in favor of plaintiff and the members of his class as a whole and, derivatively, in favor of the defendant externally managed mutual funds and the members of their class a whole.

17. The questions of law and fact common to the members of each class predominate over any questions affecting only individual members and each class action is superior to other available methods for a fair and efficient adjudication of the controversy.

18. As used herein, "defendant" includes each of the above-named defendants and any predecessors in interest thereto.

C. *Facts Conferring Jurisdiction on This Court.*

19. (a) Each defendant is an inhabitant of or is found in or transacts business in the District of New Jersey.

(b) The claim hereinafter alleged arose in the District of New Jersey.

(c) Jurisdiction is also based on the jurisdiction of this Court obtained under the other Counts of this Complaint.

D. *Facts Constituting the Cause of Action.*

20. Each defendant herein is and at all times material to the Complaint has been engaged in the sale, redemption or management of externally managed mutual funds or mutual fund shares in interstate trade and commerce to customers throughout the United States.

21. Beginning at least as early as January 1, 1965, the exact date being unknown to plaintiff, and continuing to

the present as hereinafter alleged, all of the defendants and each of their respective classes engaged in an unlawful combination and conspiracy in unreasonable restraint of the aforesaid interstate trade and commerce in the sale, redemption or management of externally managed mutual funds or mutual fund shares in violation of Sections 1 and 2 of the Sherman Act (15 USC §§ 1 and 2).

22. At all times material to the Complaint, directors or trustees of each of defendant externally managed mutual funds have been affiliated with their respective investment advisers within the meaning of the Investment Company Act of 1940, 15 USC §§ 80a-1 *et seq.*

23. At all times material to the Complaint:

(a) the self-dealing and affiliated directors and their respective investment advisers have dominated and controlled their respective externally managed mutual funds and their personnel, policies and boards of directors; and

(b) the self-dealing and affiliated directors have dominated and controlled their respective investment advisers and their personnel, policies and boards of directors.

24. At all times material to the Complaint, the contracts and other forms of agreement between the defendant investment advisers and their respective externally managed mutual funds have not been either the subject or the result of arm's-length bargaining between them.

25. Pursuant to said contracts and other forms of agreement, defendant investment advisers receive for their respective investment advisory and management services a fee calculated solely on the basis of their respective mutual funds' average net assets ("management fees").

26. For fiscal years ended on or nearest to December 31, 1967, the defendant investment advisers received management fees from their defendant externally managed mutual funds, the exact figures being presently unknown to plaintiff, in the aggregate substantially in excess of $90 million dollars. The members of the defendant investment advisers class received additional management fees from externally managed mutual funds affiliated with or related to defendant externally managed mutual funds for the same periods.

27. Said management fees are not related, nor have they been related, either to the services performed by defendant investment advisers or to the performance of their externally managed mutual funds, and are grossly excessive.

28. The combination and conspiracy involved in this action consisted and consist of a continuing agreement, understanding and concert of action, *inter alia*, between and among:

(a) each externally managed mutual fund and its respective investment adviser;

(b) each externally managed mutual fund and its self-dealing directors;

(c) each self-dealing director and his respective investment adviser;

(d) the self-dealing directors;

(e) the members of the externally managed mutual funds class;

(f) the members of the investment advisers class;

(g) the self-dealing directors class;

(h) each member of the externally managed mutual funds class and the Institute;

(i) each member of the investment advisers class and the Institute;

(j) each member of the self-dealing directors class and the Institute; and

(k) the members of the externally managed mutual funds, investment advisers and self-dealing directors classes and the Institute.

29. The substantial terms of the aforesaid combination and conspiracy were and are to:

(a) fix and adopt similar schedules of grossly excessive management fees unrelated to the services performed by investment advisers and the performance of the externally managed mutual funds;

(b) maintain and stabilize prices for the services performed by investment advisers by adherence to said similar schedules of management fees;

(c) refrain from competing for the business of externally managed mutual funds or the business of investment advisers;

(d) refrain from causing externally managed mutual funds from providing for investment advisory or management services internally; and

(e) otherwise to fix prices in, monopolize, and attempt to monopolize, the management market.

30. All of the defendants and each of their respective classes have acquiesced, encouraged, cooperated and assisted in the effectuation and maintenance of the aforesaid combination and conspiracy.

31. Various other corporations, individuals and entities who are neither defendants nor members of defendant classes herein, their identity being presently unknown to plaintiff, participated and are participating as co-con-

spirators in the aforesaid combination and conspiracy and performed acts in furtherance thereof.

32. By reason of the aforesaid combination and conspiracy, plaintiff and each member of his class and defendant externally managed mutual funds and each member of their class have paid substantially more for investment advisory and management services than they would have paid had the aforesaid combination and conspiracy not existed and will continue to do so unless defendants are enjoined as prayed herein.

33. As a result of the aforesaid combination and conspiracy, plaintiff and each member of his class and defendant externally managed mutual funds and each member of their class have been substantially injured and damaged by defendants in an amount which is presently undetermined.

WHEREFORE, plaintiff demands:

1. (a) Judgment in his favor and in favor of each member of the class represented by him in threefold the amount of the damages determined to have been sustained, together with the costs of suit, including reasonable attorneys' fees;

(b) Derivatively, judgment in favor of defendant externally managed mutual funds and in favor of each member of the class represented by them in threefold the amount of the damages determined to have been sustained, together with the costs of suit, including reasonable attorneys' fees; and

2. Final injunctive relief enjoining and restraining defendants from continuing to pay or receive grossly excessive management fees or fees calculated solely on the basis of the average net assets of any of their externally managed mutual funds; and

3. Such other and further relief as may be necessary and appropriate.

AFFIDAVIT OF APPELLANT'S COUNSEL.

COMMONWEALTH OF PENNSYLVANIA
COUNTY OF PHILADELPHIA } *ss.:*

DAVID H. PITTINSKY, being duly sworn according to law, deposes and says:

1. I am one of the attorneys representing appellant on this appeal.

2. I am authorized to and do take this affidavit for and on behalf of appellant.

3. I am a member of the bar of this Court.

4. The facts set forth in this affidavit are true and correct to the best of my knowledge, information and belief.

A. *The Putnam Growth Fund.*

5. In the affidavit of Richard M. Cutler (A. 278a-281a), it is stated that, as of December 18, 1968, the following were unaffiliated and affiliated trustees of The Putnam Growth Fund, one of the four Kauffman funds:

Unaffiliated	*Affiliated*
Vannevar Bush	Charles Devens
Robert H. Gardiner	William M. Hunt
Louis J. Hunter	George Putnam
Donald J. Hurley	Charles M. Werly
Howard W. Johnson	

6. My examination of the N-1R sworn statements filed with the Securities and Exchange Commission ("SEC") by The Putnam Growth Fund for the years ended October 31, 1965, October 31, 1966, October 31, 1967 and October 31, 1968 reveals that:

Unaffiliated Trustees.

(a) Vannevar Bush had been an unaffiliated trustee since at least November 1, 1964.

(b) Robert H. Gardiner had been an unaffiliated trustee since January 12, 1965.

(c) Louis J. Hunter had been an unaffiliated trustee since at least November 1, 1964.

(d) Donald J. Hurley had been an unaffiliated trustee since at least November 1, 1964.

(e) Howard W. Johnson had been an unaffiliated trustee since at least November 1, 1964.

(f) Stanley F. Teele was an unaffiliated trustee from January 12, 1965 to May 29, 1967.

Affiliated Trustees.

(g) Charles Devens had been an affiliated trustee since January 12, 1965.

(h) William M. Hunt had been an affiliated trustee since at least November 1, 1964.

(i) George Putnam had been an affiliated trustee since at least November 1, 1964.

(j) Charles M. Werly had been an affiliated trustee since at least November 1, 1964.

(k) A. Theodore Lyman, Jr. was an affiliated trustee from January 12, 1965 to June 22, 1967.

7. My examination of the aforesaid N-1R sworn statements filed with the SEC by The Putnam Growth Fund reveals that on January 4, 1965, October 18, 1965, April 18, 1966, September 19, 1966, April 17, 1967, October 16, 1967, May 20, 1968 and October 21, 1968, all of the unaffiliated trustees approved the investment adviser contracts in question.

8. Accordingly, the unaffiliated directors of The Putnam Growth Fund who would have voted on plaintiff's demand on December 18, 1968, had he made one, were, with one limited exception (Stanley F. Teele), precisely the same ones that composed the boards when the investment adviser contracts in question were approved.

B. *Fidelity Trend Fund, Inc.*

9. In the affidavit of Caleb Loring, Jr. (A. 284a-285a), it is stated that, as of December 18, 1968, the following were unaffiliated and affiliated directors of Fidelity Trend Fund, Inc., one of the four Kauffman funds:

Unaffiliated	*Affiliated*
C. Rodgers Burgin	Edward C. Johnson 2d
George R. Harding	Edward C. Johnson 3d
Gilbert H. Hood, Jr.	D. George Sullivan
George K. McKenzie	
Horace Schermerhorn	

10. My examination of the N-1R sworn statements filed with the SEC by Fidelity Trend Fund, Inc. for the years ended December 31, 1965, December 31, 1966, December 31, 1967 and December 31, 1968 reveals that:

Unaffiliated Directors.

(a) C. Rodgers Burgin had been an unaffiliated director since June 2, 1965.

(b) George R. Harding had been an unaffiliated director since at least January 1, 1965.

(c) Gilbert H. Hood, Jr. had been an unaffiliated director since April 26, 1967.

(d) George K. McKenzie had been an unaffiliated director since at least January 1, 1965.

(e) Horace Schermerhorn had been an unaffiliated director since at least January 1, 1965.

(f) Ronald Jones was an unaffiliated director from at least January 1, 1965 to October 31, 1967.

Affiliated Directors.

(g) Edward C. Johnson 2d had been an affiliated director since at least January 1, 1965.

(h) Edward C. Johnson 3d had been an affiliated director since April 24, 1968.

(i) D. George Sullivan had been an affiliated director since April 24, 1968.

11. My examination of the aforesaid N-1R sworn statements filed with the SEC by Fidelity Trend Fund, Inc. reveals that on December 2, 1965, December 1, 1966, January 3, 1967 and December 3, 1968 all of the unaffiliated directors approved the investment adviser contracts in question.

12. Accordingly, the unaffiliated directors of Fidelity Trend Fund, Inc. who would have voted on plaintiff's demand on December 18, 1968, had he made one, were, with one limited exception (Ronald Jones), precisely the same ones that composed the boards when the investment adviser contracts in question were approved.

C. *Manhattan Fund, Inc.*

13. In the affidavit of James H. Ellis (A. 286a-287a), it is stated that, as of December 18, 1968, the following were unaffiliated and affiliated directors of Manhattan Fund, Inc., one of the four Kauffman funds:

Unaffiliated	*Affiliated*
John S. Fielden	Gerald Tsai, Jr.
Robert W. Purcell	Joseph Auerbach
Laurence A. Tisch	

14. My examination of the N-1R sworn statements filed with the SEC by Manhattan Fund, Inc. for the years ended December 31, 1966, December 31, 1967 and December 31, 1968 reveals that:

Unaffiliated Directors.

(a) John S. Fielden had been an unaffiliated director since January 1, 1966.

(b) Robert W. Purcell had been an unaffiliated director since January 13, 1966.

(c) Laurence A. Tisch had been an unaffiliated director since January 1, 1966.

Affiliated Directors.

(d) Gerald Tsai, Jr. had been an affiliated director since January 1, 1966.

(e) Joseph Auerbach had been an affiliated director since January 1, 1966.

15. My examination of the aforesaid N-1R sworn statements filed with the SEC by Manhattan Fund, Inc. reveals that during each of the years 1966, 1967 and 1968, the unaffiliated directors submitted to the fund shareholders with their approval the investment adviser contracts in question.

16. Accordingly, the unaffiliated directors of Manhattan Fund, Inc. who would have voted on plaintiff's demand on December 18, 1968, had he made one, were, without any exception, precisely the same ones that composed the boards when the investment adviser contracts in question were approved.

D. *The Dreyfus Fund, Inc.*

17. In the affidavit of Lawrence M. Greene (A. 282a-283a), it is stated that, as of December 18, 1968, the follow-

ing were unaffiliated and affiliated directors of The Dreyfus Fund, Inc., one of the four Kauffman funds:

Unaffiliated	*Affiliated*
Lester R. Bachner	Jack J. Dreyfus, Jr.
Herbert M. Diamond	Howard Stein
Harold A. Weissman	
Robert B. Woodward	
William P. Rogers	

18. My examination of the N-1R sworn statements filed with the SEC by The Dreyfus Fund, Inc. for the years ended December 31, 1967 and December 31, 1968 and the prospectuses filed with the SEC by The Dreyfus Fund, Inc. on February 26, 1965 and May 26, 1966 reveals that:

Unaffiliated Directors.

(a) Lester R. Bachner had been an unaffiliated director since approximately January 1, 1965.

(b) Herbert M. Diamond had been an unaffiliated director since approximately January 1, 1965.

(c) Harold A. Weissman had been an unaffiliated director since approximately January 1, 1965.

(d) Robert B. Woodward had been an unaffiliated director since approximately January 1, 1966.

(e) William P. Rogers had been an unaffiliated director since approximately January 1, 1965.

(f) Howard B. Keppel was an unaffiliated director during the year 1965.

Affiliated Directors.

(g) Jack J. Dreyfus, Jr. had been an affiliated director since approximately January 1, 1965.

(h) Howard Stein had been an affiliated director since approximately January 1, 1966.

19. My examination of the aforesaid N-1R sworn statements and prospectuses filed with the SEC by The Dreyfus Fund, Inc. reveals that during each of the years 1965, 1966, 1967 and 1968, the unaffiliated directors approved the investment adviser contracts in question.

20. Accordingly, the unaffiliated directors of The Dreyfus Fund, Inc. who would have voted on plaintiff's demand on December 18, 1968, had he made one, were, with one limited exception (Howard B. Keppel), precisely the same ones that composed the board when the investment adviser contracts in question were approved.

/s/ David H. Pittinsky.
David H. Pittinsky.

Sworn to and subscribed before me this 25th day of May, 1973.

/s/ Rita L'Erario.
Rita L'Erario.
Notary Public.